China and India: Idiosyncratic Paths to High Growth

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If the Chinese economy had failed, mainstream economics would have described this as completely predictable, given the extent and nature of involvement of the Chinese state in the functioning of markets and the economy. The fact that China has succeeded therefore should lead us to question our textbook doctrines of development. Much of this paper is presented as a comparative study of India, China and, briefly, other Asian nations. It is shown that the mainsprings of development in these nations are widely different, even though their trajectories of growth are converging. The paper argues that social and political priming plays a major role in determining which economic policies will work. In the case of China, while the liberalisation from 1978 onwards was important, the social preconditioning achieved during the high-noon of the Maoist period, up to 1978, was no less significant. In judging the sustainability of growth in Asia it is essential to keep these social and political factors in mind.

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Do a counterfactual experiment. Assume that China has the political and institutional system and the structure of governance that it actually has, but that its economic record happens to be dismal. Suppose it has a growth rate that averages 2% or 3% per annum, every now and then its economy falters and actually shrinks, its unemployment is large, and its headcount ratio of poverty is high and unchanging. Most analysts and "experts" would say that this is exactly what is to be expected; that with its big and intrusive government, the exercise of "party power" over commerce and economics, and the use of controls to regulate the movement of labour, it is not surprising that China's economy is doing so badly.

Despite major moves to liberalise the economy since 1978, China remains one of the most state-owned economies of the world. Its political and institutional setting is much more socialistic than, for instance, India's. If with that setting intact, its economy had failed, it would not be unreasonable to expect that economists would uphold China's experience as a textbook demonstration of what that kind of polity does to the economy. Hence, the fact that China's economy has succeeded poses a major intellectual challenge to mainstream economics. Thus far, the principle way in which mainstream economics has met this challenge is by distorting the facts to fit the model, instead of the other way around.

If one turned to India's experience, certainly up to the end of the 1980s, it would appear the opposite. The bulk of India's production has been in private hands. In terms of the share of gross domestic product (GDP) emanating from the private sector India looks rather similar to South Korea. The history of entrepreneurship in India goes back easily a couple of centuries (see, for instance, Tata 2007). India has had a thriving and deep market for stocks and shares and in large parts of the nation the hand of government has been weak if not non-existent. In fact, some parts of India are among the most "marketised" economies of the world. You can buy virtually anything, from college degrees, through driving licences to medical certificates for good health.[1] In many of these areas there are bandits but no enforcers of the law. Since these are some of the poorest areas of India, it is evident that when we argue for freer markets and more open trade we must not confuse these with the lack of government.

Both these conclusions – for China and India – would be wrong. Our penchant for these erroneous conclusions demonstrates, more than anything else, how straitjackets are undesirable when it comes to the study of the economy; and that to do economic analysis in terms of the size of government (big government is bad or big government is good) or in terms of markets versus the state is simplistic to the point of being flawed. Markets, trade and incentives are critically important for an economy to prosper but so are social norms, institutions and the state.

1 Introduction

This paper studies the dramatic developments in the Asian theatre over the last few decades. Over centuries this was a region that slumbered. First, it was Japan that woke up; by the late 1960s Singapore, Korea, Taiwan and Hong Kong were growing at a rapid clip; by the 1980s Asia began to truly change when China began growing consistently at rates till then believed to be quite impossible for a nation as large as China. Then, by the mid-1990s, India, for long wedded to a mediocre 3% GDP growth rate – the famous "Hindu rate of growth" – suddenly broke ranks from many other developing nations in Africa, Asia and Latin America and also its own past and began surging ahead. Over the five years, 2003-08, India's GDP growth rate has averaged just short of 9% per annum. Fifteen years ago if someone had predicted this for the Indian economy the person would have been laughed out of court.[2]

Now, with even the laggards of Asia joining in on the high-growth bandwagon, it does appear that Asia is ready to claim the 21st century as its own. It could become the engine of growth for not just its own region but for the world. But how did we get here and how sustainable is Asia's growth? Those are the questions with which this paper is concerned.

It is tempting, especially for academics in search of glory, to try to explain all these nations' take-offs in terms of one overarching cause (like a theory of gravity to explain not only why apples fall when suspended in mid air but also oranges, stones and shoes), to find one pattern that explains it all. But our intellectual history is littered with grand theories of how society progresses and how our past can be described in easy patterns that have, ultimately, been proved wrong. It will be argued here that to understand economic development and design effective policy we must resist the lure of grand overarching explanations. Even if such explanations are in principle possible, the social sciences are, as yet, far from discovering them.

To understand development and why some societies take off and others do not and why, from among a host of nations caught in a poverty trap, one suddenly breaks rank we must be prepared to look at the idiosyncrasies of each society, to search in the nooks and crannies of a nation's economic, social and institutional structure. We may be lucky to ultimately stumble on one explanation that fits all, but even if we do not, research of the kind suggested above can yield valuable insights into policy and what a nation should do. This implies that, in crafting effective policies for development, we must not be wedded to simple rules of what constitutes correct policy but be prepared to make allowances for the institutional specificities of the nation in question and to improvise intelligently.

We have to also be prepared for the possibility that widely-accepted wisdoms will get turned on their heads, since economics is still a science in its nascency. About a 100 years ago, Argentina and the United States (US) seemed like two economies more or less on par and many would have predicted that Argentina would be the one to get to the fore. This turned out to be widely off the mark. Some 50 years ago, the Philippines was the nation to bet on in Asia. But somewhere along the way it stumbled and has now fallen behind the pack. Given the dismal record of the Soviet Union, many would have predicted that China, also trying to grow under a command economy, would fail, and they would turn out to be wrong. In the 1950s South Korea and India were both abysmally and comparably poor. In 1956, the US government stopped calling its financial support of Korea "development assistance" and renamed it "supporting assistance", to clarify that the aim was to provide basic consumption support since development did not seem to be on the cards (Clifford 1994). What is amazing is that this opinion was held barely a decade before Korea took off and became a story of huge economic success and left the Indian economy behind by a wide margin. Development forecasting is clearly hazardous business.

Economic Growth: Core Factors

With all these provisos in place, let me point to some findings that will form the core of this paper. It will be argued that we have too often ignored the social and institutional factors that lie behind economic growth. Take the case of China. Its growth rate did show a marked improvement, especially in terms of steadiness, from the early 1980s. This happened soon after Deng Xiaoping's economic liberalisation of the late 1970s and most analysts link the two causally. They are in all likelihood right that it is the pro-market liberalisation[3] that set China off on its searing growth path. But what is usually not recognised but is probably equally true is that the three decades of Maoist communism preceding Deng's liberalisation played a critical role in the social priming that contributed to the subsequent economic growth.[4]

China's labour force is one of the most disciplined and also acquiescent, and its civil society lines up behind the government in ways that is true of few other societies, developed or developing. Thanks to the history of iron control from 1949 to 1978, China's labour force is relatively easy to manage and control, and stands in sharp contrast to India's chaotic and demanding organised labour. During the Maoist communist period China's workers were brought into trade union membership in large numbers and the trade unions were subsequently brought under firm government control. There were periods of wage repression and strikes and work stoppages were simply not allowed. India in contrast has a small unionised labour force but the unions are powerful, can and do stop work and the government is often answerable to them.

When a new policy initiative is undertaken by the state in China, civil society usually goes along with it and the protests are in the fringes and few. This is very different compared to what happens in, for instance, the US, much of continental Europe and India, where government has to spend a lot of time and capital in persuading the population of its policy shifts before the moves are possible. It is very likely that it is the history of oppressive communism that has created these conditions in China and it is the lack of such history that makes policy management such a hard task in India. Hence, China owes its growth to the economic policies of 1978 onwards but also to the social and political priming that occurred under Maoist communism before that.

Digressing momentarily, it is interesting to ponder why doctrinaire societies, that is, ones that derive their view of the world and plan of action from some book, whether it be a party manifesto or a book of religion, often do well for extended stretches of time. The reason why this is a puzzle is that such books usually offer wisdom that is flawed, if for no other reason because scientific knowledge moves on whereas ideological or theological knowledge remains obstinately rooted to some atrophying viewpoint even when new evidence and new reasoning makes it obsolete. I believe that the one advantage that an ideological society has is its ability to solve important coordination problems. Consider a society where citizens want to cooperate and are in broad agreement about which way they want society in the aggregate to go. Despite this broad consensus this society could easily become dysfunctional because different individuals could be pursuing slightly different social objectives and failing to cooperate with others who do not share the exact same objectives. Having a manifesto or a book of religion that prescribes certain actions has the advantage that, even if the actions are flawed scientifically, they manage to achieve a certain societal coordination simply by virtue of everybody following the same text. It plays the same role that a conductor's baton does for an orchestra.

Returning to the paper's theme, one reason why India cannot just follow the Chinese example and expect to prosper is that India does not have the social preconditioning for the same policies to work. This may be one reason why some parts of India, such as West Bengal in recent times, that tried to replicate "commandeered industrialisation", as happened in China, did not fare so well. Moreover, India won her independence not through war or revolution but non-cooperation, street protests and the quiet subversion of the economy. There should be no surprise that the civil society of India, having ushered out the then most powerful nation in the world by these techniques, has now acquired an unrivalled mastery of them. The Indian government and corporations have to simply learn to deal with the great skill that India's population has for workplace subversion. India is at last managing to grow fast because of critical changes that were effected in liberalising the markets in the early 1990s but also because of concurrent social and political changes that have been occurring in the country.

With this foreword out of the way, let me begin the formal analysis by describing the broad features of contemporary Asian economic progress, before turning to a detailed, comparative analysis of China and India.

2 The Asian Theatre

Asia today is home to some of the poorest nations and most of the fastest-growing nations in the world. Nepal, Afghanistan and Bangladesh are among the poorest nations in the world's league table in terms of per capita GDP. India is home to the largest number of people who live on less than one dollar a day. At the same time, in terms of annual growth rate of per capita GDP over the last two decades, the fastest-growing nation in the world is China, followed by Vietnam and India. In terms of population growth Asia's phase of rapid increase is probably in the past; the African nations are the ones putting on the fastest additions to population nowadays. Basic data for a spread of Asian nations are provided in Table 1. For a detailed comparison of the eight nations of south Asia, see Basu and Maertens (2008).

From the column in Table 1 giving per capita income, it is interesting to see that India, which used to be behind Pakistan and vastly behind Indonesia, is now ahead of Pakistan and rapidly closing the gap with Indonesia in purchasing power parity-corrected per capita income. On the other hand, Korea and India which in the 1950s looked pretty similar are so different today that they have, coincidentally, the same national income, even though India's population is 22 times that of Korea's (see Krueger 1998; Panagariya 2008). The growth rate figures in this table are a bit misleading, since there are yearly fluctuations and it is best to look at growth rates averaged over a few years. Doing so will make it clear that, Singapore, which had a record that was by some measures the best in Asia, ahead even of Japan, has now slowed down, as is natural for a very rich nation. India, as mentioned earlier, has been growing fast over the last 15 years and very fast over the last five. Its growth rates in 2005, 2006, 2007 and the first half of 2008 were, respectively, 8.7%, 9.1%, 8.4% and 9%.[5] The table also shows how the Philippines has slid rank, and that Indonesia never really fully recovered from the east Asian crisis of 1997-98, since political problems erupted with the crisis and stifled the country's economic performance. This is in sharp contrast to the other east Asian nations that were caught in the crisis and, in fact, used it to restructure their economies (Aziz 2007).

Table 1: State of the Economy (2007)

	Population (Million)	GNI (Billion $)	GNI Per Capita ($)	GNI Per Capita PPP ($)	GNI Growth Rate 2006-07 (%)	Population Growth Rate 1990-2007 (%)
China	1,320	3,293	2,360	5,370	11.6	0.9
India	1,123	1,166	950	2,740	9.7	1.7
Indonesia	226	416	1,650	3,580	6.6	1.4
Korea, Rep	49	971	19,690	24,750	5.4	0.7
Pakistan	162	146	870	2,570	6.8	2.4
Philippines	88	158	1,620	3,730	6.1	2.1
Singapore	5	156	32,470	48,520	8.7	2.4
Thailand	64	238	3,400	7,880	5.9	1.0
Vietnam	85	70	790	2,550	8.0	1.5

Source: *World Development Indicators, 2008*, World Bank.

One negative change that has occurred during this otherwise good period and is not captured in Table 1 is a steady rise in inequality. This is true for all the Asian nations, with the exception of Thailand. In China, inequality is rising and is now higher than in the US and Russia.[6] Japan, once the bastion of equality, has seen a steady increase in inequality (Burton and Zanello 2007). Inequality in Korea has been large for much of the 20th century and seems now to be growing further (Oh 2008). This rise in intra-country inequality is probably, as I shall comment later, beyond the control of any single country. It is a fallout of globalisation and the only way to control this is by using some policies that are coordinated across nations.

Economies on the Ascent

What are the reasons behind the Asian economic boom over the last few decades? As it turns out it is a motley collection of reasons that do not have too many common features. Among the common explanations is Justin Yifu Lin's (1996) argument that all these Asian nations began with the prevalent theories of the time – the need for import substitution, the emphasis on heavy industries and the planned control of the industrial sector. As these policies turned out to be failures, the nations with shallower pockets were forced to make the changes earlier. The more stable and larger economies, like China and India could hold on to the old policies longer than the less resourceful economies such as Singapore and Korea. In the case of India it is indeed true that it was a crisis, arguably the biggest faced by independent India, that triggered the policy changes that were long on the anvil but no government, for reasons of politics and group interest, actual or illusory, had the courage to undertake. The first Gulf War 1990-91 brought India precipitously close to defaulting on its international debt commitments and became the peg on which major changes were initiated.

The social and political situation matters more than is acknowledged by economists. India is moving into a strategic position globally, whereby it is viewed as a counterpoint to a face-off between China and the US, and in the Asia-Pacific region it has emerged as one of the key players, along with China, Japan and the US (Pant 2007). This has helped the Indian economy, as has the fact that India and the US have shared concerns about the rise of terrorism. Likewise, India's democracy, while of great value in itself, may also have played a role in slowing down the nation's trajectory of development. I shall however argue later that it is India's democracy that is likely to give its high recent growth sustainability in the long run.

Some detailed analysis of south Asian data suggests that the whole of south Asia, excluding India, is growing faster than the rest of the world and so there is hope that Asia's laggards will also now join in the boom. There may indeed be merit in Martin Wolf's prediction in the *Financial Times* of 23 February 2005, where he is talking about Asia and mainly about China and India: "The economic rise of Asia's giants is, therefore, the most important story of our age. It heralds the end, in the not too distant a future, of as much as five centuries of domination by the Europeans and their colonial offshoots."[7] This will have momentous consequences for the world. There is a lot of hyperbole on the subject and some wild-eyed patriotism. But what does dispassionate analysis yield? I shall in the next sections analyse mainly how we got here. This, of course, has implications for what the future is likely to look like. I will make some comments on the latter but my focus in the remaining pages is on the triggers of Asian growth and, in discussing these, the special focus will be on the case of China and India.

It should be mentioned, if only to put it aside, that in the immediate run – the next two or three years – the prospects for Asia do not look good, thanks to the global crisis, caused, initially, by the rise in crude oil and food prices and, after this subsided, by the sub-prime crisis which led to a recession in the industrialised world and spilled over to the emerging economies. Crude oil prices rose by 35% over the previous to last year, causing slowdowns in the US economy and Europe, with huge fallouts for the rest of the world. Global food prices also rose over the last three years. During one year before the last one the average price of food had risen by 56%, with wheat price rising by 92% and rice, the staple of half the world, by 96%. There were food riots in the Philippines and Indonesia and in Bangladesh 20,000 textile workers went on a rampage. Both China and India protected their consumers from the oil price rise by using subsidies. As soon as the inflationary crisis ended, the sub-prime mortgage crisis and industrial recession in the US, Europe and Japan picked up and has caused big hardships for the export-oriented Asian economies. Serious though this crisis may be, it does not alter the long-run prospects of China, India and the other Asian economies.

3 China and India: What Were the Triggers?

But for the fact that China has had sustained high growth, experts would have convinced us that China cannot have sustained high growth. Before China, communist regimes had experienced growth spurts and done well as sprinters, but none had witnessed lasting growth. This is true of the USSR, North Korea and many other nations. Breaking that trend, China has now had high growth for three decades.

There can be no denial that this goes against the conventional wisdom of textbook economics.[8] Despite the market-oriented reforms of 1978-80, which were significant in comparison to the draconian control of the Chinese state previous to that time, in China the "socialist planning system still operates, ….the labour responsibility system determines where a person can work legally and where it cannot, … all land is owned and controlled by the State," and the Chinese Communist Party continues to vet all senior appointments in firms and "even if the CEO is not a party member, there will be a party member (or group of members) ostensibly junior(s) in the organisation who can over-rule him on 'ideological' grounds, …in China banks are not intermediaries but instruments of the State… ." These quotes are from Virmani (2006), who in his comparison of India and China has repeatedly stressed the importance of free-market policies.[9]

For most analysts, using standard models of economics, explaining China's performance is a hard task. To understand China's development one has to think out of the box. One of the best analyses of China's success is that by Lin, Cai and Li (1996) (see also Lin 1998). They demonstrate that thinking in terms of broad categories, such as socialism and capitalism or big and small governments, and trying to link these to growth is the wrong way to approach the problem. Markets and incentives play a critical goal for development to occur, and, as long as the government has the intelligence to weave these into the policy fabric, the stage is set for economic take-off. Further the Chinese government has intervened in macroeconomic markets by keeping tight controls on capital and has kept its exchange rate deliberately undervalued in order to break into global markets with its exports. As Prasad (2008) rightly points out, these are not strategies worth emulating by other countries. Nevertheless, their success in China is somewhat of a puzzle and may have something to do with the nation's history.[10]

Centralised Doggedness

In addition, I believe that the 30 years of draconian communism from 1949 to 1978, instilled a docility in the nation's citizenry, which has played an important role.[11] This in itself would have been of no use if the government was corrupt or unintelligent. But the Chinese government was none of those. Deng Xiaoping was one of the most intelligent leaders, who understood the vital role of incentives for households, farms and manufacturers. Though he was unwilling to give up the state's huge control, he realised the need to allow agents to take their own profit-maximising decisions freely. In addition, by the 1980s, China's by-then amenable labour force made it easy for government to usher in policy changes with an ease that would be inconceivable in democratic countries.

It is not being argued that these are innate qualities. As will be argued presently, beneath the surface, there is enough evidence of individuality and rebelliousness in China. It will be claimed that therein lies the main risk for the economy. If China's future leaders do not have the astuteness to allow these forces to vent, the forces can push the political leaders into a corner and give rise to fractiousness and policy perversions.

One standard predicament of highly-centralised, one-party governments is that they eventually get into a situation where the leaders are no longer wanted by the people and yet they have no easy exit. If they relinquish power they are likely to be persecuted and punished. So it is not so much the love of power as the fear of what lies on the other side that makes them cling on to their posts. Once this happens, policies are guided no longer by national development interests but narrow survival instincts; and growth begins to falter and political power is lost, but only in its wake.

The kind of social engineering that contemporary China attempts is quite unthinkable in most nations. On 7 February 2008, Xinhua, China's official news agency announced that the civic index of Beijingers was 73.38 in 2007, up from 65.21, the percentage of Beijingers who spat on roadside was 2.53% in 2007 down from 4.90% in 2006. No matter how these indices are constructed it was interesting to see heightened interest in these as the Olympics approached. And to spur on improvement in civic matters like the above, the government launched initiatives like "queuing day", which required that on the 11th of every month government officials would go out all over the city to tell citizens "it is civilised to queue, glorious to be polite". Then there was the "seat giving day" once a month when the young and fit were encouraged to give up their seats in buses and trains to the old and less abled (Gardner 2008). Clearly, the state in China feels able to influence what in most societies is left to parents and guardians to struggle with (usually without success) within the confines of their household.

One sees evidence of centralised control and submission of the citizenry in China's population policy. The original view was that socialism can cater to a population of any size and, in addition, Mao Tse Tung believed that a larger population would lead to greater strength and so the citizens were encouraged to have large families. Anybody who proposed family planning was immediately silenced.[12] By the 1970s China fertility was extremely high. But by the late 1970s the government changed its mind on population and initiated draconian measures to control the population. By the 1990s the one-child policy had become the norm. All this stands in sharp contrast to India where an effort to have aggressive family planning by a dictatorial government during 1975-77 resulted not in family planning but in the government being overthrown.

There is evidence of some of the same centralised doggedness in China's entry into Africa. The foreign direct investment and aid that China is pouring into Africa, seems to have a clear economic rationale. The bulk of the money is going where returns are likely to be higher (Biggeri and Sanfilippo 2008) and there is a sovereign rationale to this that is not always there when a multitude of corporations from an industrial capitalist nation goes into the developing world.

The Quiet Dissent

It is a contention of this paper that this control over civil society which has helped China prosper is also its greatest risk. If the kinds of control mentioned above occurred because individuality was actually absent in society, then there may be little risk from this. But there is enough evidence that that is not the case. I am not just thinking of the occasional protests, such as the Tiananmen Square uprising,[13] but also the remarkable flowering of individual talent and creativity that one sees in China today. The most remarkable evidence of this is in contemporary art. The originality and creative audacity of Chinese artists is quite breathtaking. The level of experimentation that one finds in the works of artists like Wang Guangyi, Fang Lijun, Zhang Xiaogang, Yue Minjun, Zhong Biao and several others may well be comparable to the revolutionary art movements one saw in Europe in the 19th and early 20th centuries. These are indicators of what is happening beneath the surface calm of an organised and pliant society. Though the world of art and humanistic talents appears distant from the world of commerce and economics, one can read off indicators of what is to come in the future by looking into the state of these individual pursuits.

There is also evidence from ethnographic research that policies which appear to run seamlessly on the surface are often met with quiet dissent. There is, for instance, evidence that the harsh population policies are frequently subverted by ordinary citizens, at times even with the consent of officials (Greenhalgh 1994). The famous experiment of farmers in Anhui province in 1978 to secretly experiment with contract farming was an act of subversion. In that case, the subversion became a harbinger of desirable change, but that need not always be the case. Unless these subterranean forces are allowed to come to the surface naturally, they can become unmanageable and disruptive.

China's Growth: A Puzzle

Let me turn back from speculations about the future to understanding how we came to be where we are. The best way to get an understanding of a nation's performance is to look at its growth chart and keep in mind the major events – economic, political and social, that underlie the growth numbers. I have therefore provided in Table 2 and Figure 1 (p 48) the basic data and graph on China's growth. Just eyeballing these can be instructive. Underlying this remarkable growth performance is an investment and savings rate (Figure 2, p 49), which as its percentage of GDP is unrivalled in the world. The east Asian super-performers, such as

South Korea, Hong Kong (before 1997), Singapore and Taiwan, have all been high savers, investing and saving over 30% of their national income, though none of these nations reached the height China reached.[14] Standard growth theory prompts us to expect that high investors will have high growth and China fits this model well (see Prasad 2008a, for discussion on this). But this is where the help that one get from textbooks in understanding China ends.

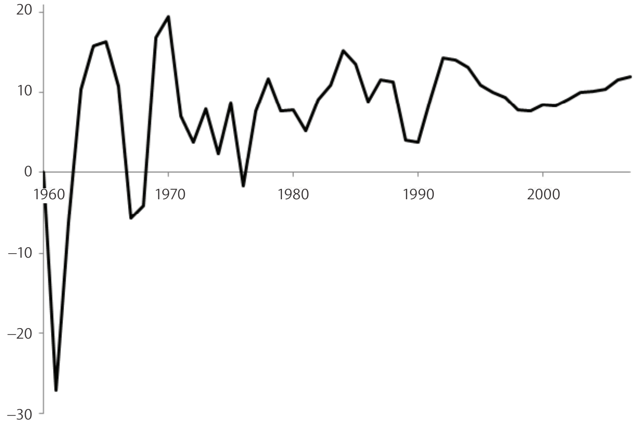
Table 2: China's Progress

	GDP Growth (Annual %)	Gross Domestic Savings (% GDP)	Population Growth (Annual %)	Export of Good/Services (% GDP)	GDP (Billion 2000 $)	Population (Millions)
1960	..	..	1.83	..	70.35	667.1
1961	-27.10	..	-1.02	..	51.28	660.3
1962	–6.11	..	0.82	..	48.15	665.8
1963	10.34	..	2.46	..	53.13	682.3
1964	15.84	..	2.32	..	61.55	698.4
1965	16.36	..	2.38	..	71.62	715.2
1966	10.70	..	2.79	..	79.28	735.4
1967	–5.70	..	2.57	..	74.76	754.6
1968	–4.10	..	2.61	..	71.70	774.5
1969	16.90	..	2.74	..	83.81	796.0
1970	19.40	28.93	2.76	2.61	100.07	818.3
1971	7.00	29.29	2.75	2.76	107.08	841.1
1972	3.80	27.16	2.46	3.18	111.15	862.0
1973	7.90	29.99	2.28	4.33	119.93	881.9
1974	2.30	28.73	2.07	4.98	122.69	900.4
1975	8.70	30.19	1.77	4.59	133.36	916.4
1976	-1.60	28.27	1.55	4.81	131.23	930.7
1977	7.60	28.87	1.36	4.69	141.20	943.5
1978	11.70	37.55	1.34	6.64	157.72	956.2
1979	7.60	35.70	1.33	8.57	169.70	969.0
1980	7.80	35.04	1.25	10.71	182.94	981.2
1981	5.20	34.04	1.28	12.65	192.45	993.9
1982	9.10	35.85	1.47	12.32	209.97	1,008.6
1983	10.90	35.35	1.44	10.91	232.85	1,023.3
1984	15.20	35.02	1.31	11.34	268.25	1,036.8
1985	13.50	34.44	1.36	10.00	304.46	1,051.0
1986	8.80	35.76	1.49	11.82	331.26	1,066.8
1987	11.60	37.27	1.60	16.36	369.68	1,084.0
1988	11.30	36.80	1.61	17.05	411.45	1,101.6
1989	4.10	36.43	1.53	16.70	428.32	1,118.7
1990	3.80	39.88	1.47	19.17	444.60	1,135.2
1991	9.20	40.00	1.36	20.95	485.50	1,150.8
1992	14.20	39.64	1.23	22.53	554.45	1,165.0
1993	14.00	42.41	1.15	23.30	632.07	1,178.4
1994	13.10	44.02	1.13	24.57	714.87	1,191.8
1995	10.90	44.11	1.09	23.07	792.79	1,204.9
1996	10.00	42.49	1.05	20.05	872.07	1,217.6
1997	9.30	42.44	1.02	21.75	953.17	1,230.1
1998	7.80	41.40	0.96	20.35	1,027.52	1,241.9
1999	7.60	39.57	0.95	20.40	1,105.61	1,253.7
2000	8.40	37.53	0.71	23.33	1,198.48	1,262.6
2001	8.30	38.39	0.73	22.60	1,297.95	1,271.9
2002	9.10	40.44	0.67	25.13	1,416.07	1,280.4
2003	10.00	43.40	0.62	29.56	1,557.67	1,288.4
2004	10.10	45.81	0.60	33.95	1,715.00	1,296.2
2005	10.40	49.42	0.64	37.30	1,893.36	1,304.5
2006	11.60	52.26	0.56	39.94	2,112.99	1,311.8
2007	11.90	..	0.62	..	2,364.44	1,320.0

Source: *World Development Indicators 2008*, World Bank.

Figure 1: China's Growth

Annual growth in GDP (%) for China (1960-2007)



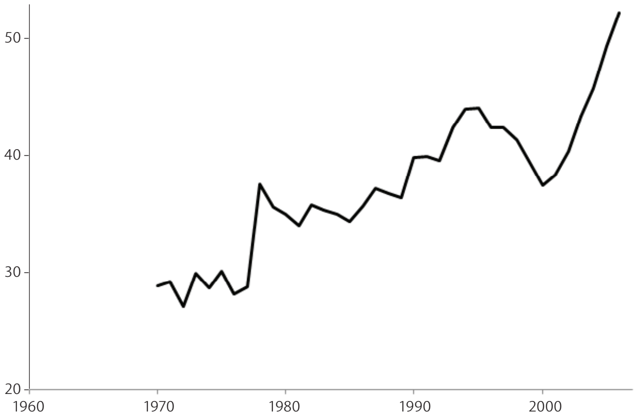
What the data and the graphs reveal is that the main difference in the periods before 1978 and after is, interestingly, not so much in the average growth rate, as in the volatility. It is virtually become an axiom that China took-off in 1978 and this was caused by the market reforms. In his fascinating book on the rise of modern China and its implications for global politics and world peace, Kang (2008: 3) writes, without further need to justify, "China has rapidly emerged as a major regional power, averaging over 9% economic growth since the introduction of its market reforms in 1978". What I am arguing in this paper is that, even with the market reforms, the Chinese economy continues to be vastly more state-controlled than any industrialised nation and any rapidly growing developing country. It is, therefore, a puzzle that China has grown so fast for such a long period; there are no parallels in history.

Second, the so-called big break in 1978 is not as sharp as is popularly made out to be, in order to ensure that textbooks of economics do not come out poorly. The average growth has been faster after 1978 but there were periods of rapid growth before that. What is true is that the downward plunges that the Chinese economy experienced every few years, up to 1978, did not happen after that time. In the pre-1978 period the highs and lows of growth rates that China achieved would be unthinkable in many other nations. In 1961 China's income collapsed by 27% but in 1969 and 1970 its income grew by 17% and 19%, respectively. In recent times, these kinds of extremes from one year to another one sees in only a few Asian countries. We see it, for instance, in Afghanistan, which is war ravaged and strife-torn.

China's income collapse of 1961 was caused by the disastrous Great Leap Forward policy and it must be recalled that 1959-62 was also the time of China's big famine when anywhere between 15 and 30 million people died. But China's phenomenal growth in 1969 and 1970 is difficult to explain; it does not fit easily into the theory that it was liberalisation á la Deng that boosted growth. In 1969 the Cultural Revolution had officially ended – this happened in April of that year – but some of the most oppressive practices continued. In fact, state coercion and oppression was spread to the rural areas in the 1970s where "peasants were required to abandon all sideline occupations such as raising pigs, chickens and ducks in order to cut out the tail of capitalism" (Fairbank and

Figure 2: China's Savings

Gross Domestic Savings (% of GDP) in China (1970-2006)



Goldman 2006: 398). Yet despite the clampdown on private enterprise, the aggregate Chinese economy continued to surge ahead. The science of economic development is clearly a more complex discipline than is made out to be.

China did badly in the mid-1970s but that was a bad time for the whole world, with the old exchange rate regimes being abandoned for a new uncertain world and oil prices registering a sharp rise. After China's reforms of the late 1970s there was no looking back for the country. In fact, when the Latin American crisis of 1982, caused by the huge international debt build-up, came, that had no effect on China, which was by then on a fairly steady 10% per annum growth path.

Market Liberalisation in India

India's growth pattern as well as the genesis of its high growth since 1994 has been very different from that of China's. Some of the conundrums of why growth occurred when it did remain and easy explanations do quite badly. India's most important growth spurt occurred from 1994 onwards, immediately following the market-oriented reforms of 1991-93 initiated by the then finance minister (and current prime minister), Manmohan Singh. Before that time a combination of interest-group lobbying, regressive thinking and the politics of playing it safe by doing nothing had begun to stifle the economy. The manufacturing sector was virtually throttled by a draconian licensing system (Mohan 1992), trade was hampered by a system of sky-high tariffs, quantity-controls on imports, and an archaic exchange-rate control system, and markets in general were harmed by a labyrinthine system of labour regulation. The first Gulf War brought India close to a default on its international debts. In mid-1991 India had enough foreign exchange for only 13 days of normal imports. This allowed the government to usher in much needed market liberalisations. The licensing system was revoked altogether, tariffs were brought down sharply over the next three years (there is still some distance to go on this, I believe) and the exchange rate was no longer controlled. The labour laws and regulations were however untouched and they remain untouched even now. I will have more to say on this shortly. The effects of the reforms were almost immediate. The crisis was over by mid-1992. From 1994 the economy grew at around 7% per annum for three consecutive years, slowed down a little during the Asian crisis of 1997-99, but growth has not looked back since then.[15]

The major reforms were in the international sector and the fiscal sector and, not surprisingly, the biggest impact has been in those sectors. India used to have a foreign exchange balance of around $5 billion. It was approximately that in 1977, it was approximately that in 1992. Since then it has been a steady and exponential rise and last year it breached the $300 billion mark. The haemorrhaging fiscal deficit was also much more under control, especially since there is a fiscal responsibility law that compels government to cut revenue deficit (Chidambaram 2007).[16]

With the growth spurt that occurred over the last five years and the rise of the Indian corporations as global investors – on this India's rise has been more striking than that of China – India's medium to long-run prospects look very good. In addition, one development of the last five or six years that augurs well for both India and China, and especially the former, is the growth of trade and the flow of foreign direct investment between the two countries. The two nations, despite an ancient history of intellectual exchange and collaboration (see Sen 2004, for discussion), had very little economic interaction over the last several decades. Facilitated by China's joining the World Trade Organisation (WTO) in 2001, this has been changing dramatically in recent times. Trade between the two nations has been rising at close to 50% per annum and it is possible that China will replace the US as India's largest trading partner over the next three years. This should help iron out some of the relatively minor contentions that exist between the two countries concerning some stretches of the boundary between the two nations. In general, the growing economic links between the two nations can be a major stabilising factor for all of Asia and can promote even greater economic development in both nations.

Despite these favourable developments, there are many more reforms that need to be implemented in India. The labour laws need to be amended allowing for easier hiring and firing of workers. I believe this will help workers by causing wages to rise and increasing their bargaining power (Basu, Fields and Debgupta 2008). India needs to invest in better infrastructure. The bureaucracy needs to be cut down severely and trade and investment need to be liberalised further. But the economy is a funny thing. It is not as if policies of the same genre work at all times in all places. For this reason, ideologues do not make for good policymakers. One can see the complexity of economic management by studying India's record. I described the reforms of 1991-93 as the most important policy changes of post-independence India. But the growth spurt of 1993 was not the first. The first breakaway from the 3% or so Hindu rate of growth occurred in the mid-1970s. We have tried to argue elsewhere (Basu and Maertens 2007) that this was caused by the rise in the savings and investment rate that occurred in the early 1970s. But why did savings rise then? In the same paper I have argued that this was, in turn, caused by the nationalisation of banks by Indira Gandhi in 1969. Following the nationalisation she directed the state-owned banks to open up branches in remote areas of the nation, where profit-driven private banks had refused to go earlier. Data show a sharp rise in the number of bank branches in India through the 1970s.

Something similar is true for India's celebrated information technology sector. As one of the great entrepreneurs of information technology, Narayana Murthy (2000), has recorded, the initial boost to this sector came from the government showing IBM the door in 1977. This compelled the indigenous computing sector to flourish. The later market liberalisation of 1991-93 was equally important. Without that freeing up India would never have been able to capitalise and make good on its software promise by utilising the boost received from the closing of the economy in 1977 (Murthy 2007).

Table 3: India's Progress

	GDP Growth (Annual %)	Gross Domestic Savings (% GDP)	Population Growth (Annual %)	Export of Good/Services (% GDP)	GDP (Billion 2000 $)	Population (Millions)
1960	..	12.39	1.85	4.57	78.65	434.8
1961	3.87	13.07	2.19	4.37	81.69	444.5
1962	3.13	13.74	2.25	4.26	84.25	454.6
1963	6.28	14.12	2.29	4.38	89.54	465.1
1964	7.44	13.61	2.32	3.87	96.19	476.1
1965	-2.41	14.20	2.34	3.35	93.88	487.3
1966	-0.04	13.81	2.34	4.19	93.84	498.9
1967	7.83	13.07	2.34	4.09	101.19	510.7
1968	3.37	13.25	2.34	4.09	104.61	522.8
1969	6.54	14.79	2.32	3.76	111.45	535.1
1970	5.15	15.49	2.31	3.83	117.19	547.6
1971	1.63	16.37	2.29	3.71	119.10	560.3
1972	-0.55	16.29	2.27	4.08	118.45	573.1
1973	3.32	15.96	2.26	4.26	122.38	586.2
1974	1.18	16.93	2.26	4.89	123.83	599.6
1975	9.15	17.78	2.28	5.71	135.16	613.5
1976	1.66	19.50	2.28	6.76	137.39	627.6
1977	7.26	18.59	2.28	6.46	147.37	642.1
1978	5.71	20.24	2.28	6.39	155.78	656.9
1979	-5.24	19.77	2.27	6.83	147.62	672.0
1980	6.74	15.41	2.25	6.21	157.58	687.3
1981	6.00	19.52	2.23	6.00	167.03	702.8
1982	3.47	19.24	2.20	6.05	172.82	718.4
1983	7.30	17.45	2.15	5.91	185.43	734.1
1984	3.82	19.89	2.10	6.36	192.52	749.7
1985	5.23	21.05	2.04	5.31	202.60	765.1
1986	4.77	21.18	2.16	5.25	212.26	781.9
1987	3.96	20.61	2.12	5.67	220.66	798.7
1988	9.64	22.20	2.10	6.10	241.93	815.6
1989	5.95	22.57	2.06	7.10	256.32	832.5
1990	5.53	22.74	2.02	7.13	270.49	849.5
1991	1.06	21.98	1.98	8.59	273.37	866.5
1992	5.48	23.02	1.86	8.94	288.35	882.8
1993	4.77	21.24	1.85	9.95	302.10	899.3
1994	6.65	23.22	1.80	10.00	322.20	915.7
1995	7.57	25.40	1.78	10.97	346.59	932.2
1996	7.56	20.95	1.76	10.51	372.78	948.8
1997	4.05	22.65	1.74	10.82	387.90	965.4
1998	6.19	20.95	1.72	11.15	411.92	982.2
1999	7.39	24.15	1.70	11.66	442.35	999.0
2000	4.03	23.24	1.68	13.23	460.18	1,015.9
2001	5.22	23.29	1.62	12.76	484.19	1,032.5
2002	3.77	24.24	1.55	14.49	502.43	1,048.6
2003	8.37	25.48	1.49	14.80	544.49	1,064.4
2004	8.28	29.82	1.43	18.07	589.56	1,079.7
2005	9.24	31.71	1.37	19.89	644.02	1,094.6
2006	9.69	32.98	1.38	22.09	706.43	1,109.8
2007	9.03	35.10	1.21	21.32	770.20	1,123.3

Source: *World Development Indicators 2008*, World Bank.

Savings and Investment Rate

One common feature of both China's and India's growth experience is the salience of the savings rate and the investment rate. As remarked earlier, this is also true for the other Asian nations. The rise of these rates seems to be a precondition for sustained high growth. For China this was taken for granted for long. China has always had a fairly high savings rate, but as Table 2 and Figure 2 show, the rate never dropped below 30% from 1977 onwards and, as we know, China's growth rate showed particular robustness from 1978. For India the connection between savings and growth has not been as obvious. As Table 3 and Figures 3 and 4 (p 53) show, and this is a matter on which economists have commented, the sharp rise in savings in the early 1970s did not immediately translate into growth. I believe that there were some infrastructural bottlenecks that held back the economy. And, in any case, by the late 1970s and certainly the early 1980s it was evident that the economy was growing faster.

Interestingly, India has witnessed another very sharp rise in its savings rate over the last four years. The rate climbed up from 24% to 34% – according to the latest *Economic Survey*, the savings rate is 37.7% (Government of India 2009). For the first time India is saving and investing at rates which have been associated with the Asian tigers. This is so recent that this has not yet been analysed sufficiently. But this augurs extremely well for the country.

Since savings rates do not fluctuate as wildly as many other economic indicators, there is reason to expect that India is now in the over – 30% range for some time to come – maybe a decade or two. This should help India sustain an annual growth rate of 9% (once the global recession is over). If, in addition, the country manages to implement some major reforms, like curtailing bureaucracy and liberalising labour laws, a sustained growth rate of over 10% per annum seems achievable. Unlike China's growth, the driving force of which comes from the top and the government, India's growth surge seems to be a bottom-up process. This makes, for the first time in decades, the sustainability prospect of India's high growth better than that of China.

It is arguable that there is nothing more China can do to step up its growth rate – it is already growing at full throttle. Some people argue that China's investment, especially that part which comes from the state-owned enterprises, is extremely inefficient. So it is possible for China to cut down on investment and not have any affect on growth. Its big challenge is to increase the efficiency of the investment undertaken by the state (Dollar and Wei 2007).

State-Owned Sectors

India's big problem now is that its government is in the wrong places. It is not a problem of size as much as location. In terms of the fraction of the national income that is produced by state-owned enterprises, India is not an outlier in Asia; and compared to the communist and former communist nations, India is a very privatised economy. While the output emerging from state-owned enterprises in 1990 in India was 14.1%, the figure for

Figure 3: India's Growth
Annual growth in GDP (%) for India (1961-2007)

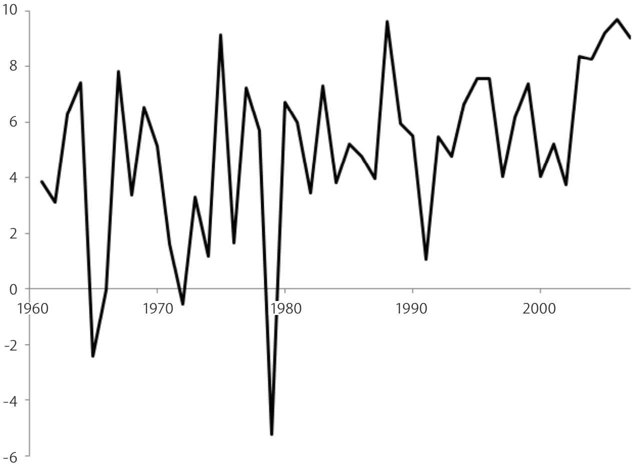
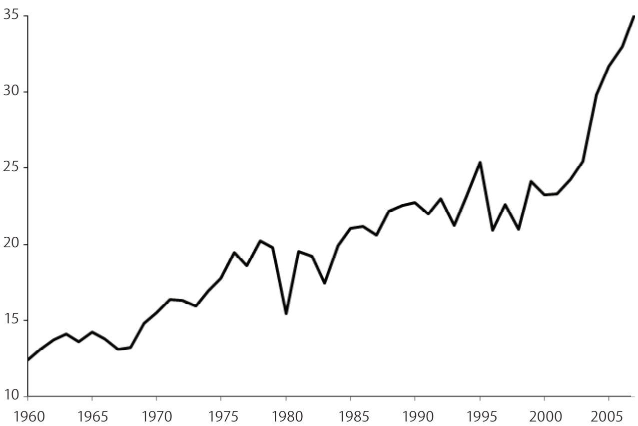


Figure 4: India's Savings
Gross Domestic Savings (% of GDP) in India (1960-2007)



China in 1985 was an astonishing 70%. Though state-ownership has been declining, even today it is around 50% in China (Dollar and Wei 2007), which is way higher than all the nations listed in Table 4.[17] It is not just that, as Huang (2008: ix) observes, "As late as 1998 much of the Chinese officialdom held private ownership in utter contempt". Table 4 shows, in 1978, South Korea had a larger share of output coming out from the state-owned sector than India. The ranking had changed by 1990 but that gap was not large. Indonesia looks similar to India; Malaysia has a distinctly larger share of state production and the Philippines is the most privatised economy – with a large part of that, at one time, in the firm private grip of Marcos.

While the size of government is not India's problem, the nature of its engagement especially in the industrial and services sector, has turned out to be obstructive. This is evident from Table 4. Moreover, where it is most needed – in enforcing contracts between agents – it has been either non-existent or has encouraged the reneging. The number of days that it takes for the government to enforce a contract that one party to the agreement is trying to renege on is 120 in Singapore, 406 in China and a handsome 1,420 in India.

The labour market regulation imbroglio is actually a part of the same problem. Instead of creating room for different kinds of contracts between workers and employers, the effort is to use the law to impose certain terms exogenously. This may be well-meaning but is not good for the workers' well-being. Consider for instance the textile and apparel sector. Given the volatile demand from the fashion garment sector, especially from the industrialised nations, a firm may have to be prepared to hire lots of workers when the demand is high and then downsize when the demand declines. As the CEO of a leading textile export concern, Orientcraft, told me, he projects the demand for labour during the slack periods and keeps his labour force size down to that, just so as not to be burdened with an un-viably large workforce. This shows up in the indicators of the firing index and the time taken to close down a bankrupt firm displayed in Table 4. Among all the Asian countries described in Table 4, India is a total outlier on both these scores. If with the other advantages that India has had in recent times, it can put its bureaucratic house in order and have a better system of contract enforcement, it can free up the labour-intensive manufacturing sector and achieve a very high growth rate.

Where government is needed and inadequately available in India is in the provision of infrastructure and in the social welfare sector. On infrastructure the awareness is now high in government and there is reason to expect large changes over the next five years. On social welfare the situation is still bleak. Poverty is still very high with around 250 million people below the poverty line (and India's poverty line is quite a bit below one dollar a day).[18] If the poor and the dispossessed develop some other identity – for instance, based on caste or regional origin, then this can be politically destabilising. Government needs to do much more in eradicating poverty.

The risk of political destabilisation is there also for China (Prasad 2008a) and may be even greater than what India faces. These risks manifest themselves in different ways in China. I

Table 4 : Size of Government

Country	Share of State-owned Enterprises in GDP 1978	Share of State-owned Enterprises in GDP 1990	Share of State-owned Enterprises in Non-agricultural Economic Activity 1978	Share of State-owned Enterprises in Non-agricultural Economic Activity 1990
India	9.1 (1980)	14.1	13.9 (1980)	18.9 (1989)
South Korea	10.4 (1980)	10.2	12.2 (1980)	11.2
Pakistan	8	11.6 (1988)	12.8 (1980)	16
Thailand		5.4 (1988)		6.2 (1988)
Malaysia		17 (1986)		21 (1986)
Philippines	0.9	3 (1989)	1.3	3.9 (1980)
Indonesia	13.8	13 (1989)	19.2	17
China				
Singapore				
Vietnam				

Source: World Bank, *Bureaucrats in Business (1995)*, Oxford University Press.

Table 5: Bureaucratic Efficiency

Country	Starting Business (Number of Days)	Number of Days to Enforce Contract	Number of Months to Close Business	Difficulty of Firing Workers Index
India	33	1,420	120	70
China	35	406	20	40
Singapore	5	120	10	0
South Korea	17	230	18	40
Pakistan	24	880	34	30
Thailand	33	479	33	0
Malaysia	24	600	28	30

Source: *Doing Business (2008)*, World Bank.

have attributed a large part of China's success, despite its government's overtly interventionist behaviour vis-à-vis the market, to the fact that it was intelligent intervention. Contending with the same argument Yao (2008) argues that China succeeded because it has had a "disinterested government", meaning it has not played one group against another but has been a neutral referee. This is a valid argument. But what stands out even more is that China has had the luck of an intelligent government. It has cleverly held back damaging intrusions into the market. This, however, always has the risk of changing. As argued, when an agent is as powerful as China's government is, it can easily fall prey to the temptation of exercising that power in the interests of itself or a small group. This can also be not a response to temptation but self-preservation in times of turmoil. China's excessively pliant civil society could cease to be that under times of stress, for instance, a period of growing unemployment or inflation. Its attempt to dislodge those in power can easily result in a siege mentality on the part of the government, whereby it becomes impossible for it not to exercise the vast powers that it already has.

4 Notes on Markets and Interventions

There is an analytical subtext to what was written above and this last section is meant to elaborate on it. An important underlying message is the need not to blind oneself with ideological rules about how to run an economy. Of course, we have our normative preferences. Some may want a high growth society and another person may be prepared to compromise on growth in order to have a better distribution. On the normative objective differences, there is not much to debate about. It is a case of "my values versus yours". But in translating a given objective to what should be done on the ground, the only criterion should be that of science. We must use the best available data and best reasoning to develop policy rules.

To do otherwise is to fall into regressive policy traps and contradictions. Let me illustrate this with a contradiction in conservative, right wing thought. It is a common precept of such thinking that, (a) if a change is Pareto improving, there must not be any third party intervention to stop it. While being aware that there are exceptions to this rule, I subscribe to it and believe that a huge amount of harm has been done by governments wantonly violating this. Hence, when a rational buyer and a rational seller want to transact and there is no obvious externality from the transaction, the government should, typically, not stop the transaction. Another common axiom of conservative thought is that (b) a person's choice reflects his or her utility. If a person chooses x over y, the person must be better off with x over y. This is at times referred to as consumer sovereignty.

I have in some of my writings criticised the government ruling in some parts of India whereby the owner of a property – an apartment, for instance – is not allowed to sell it. This is usually true of property that the government originally sold at below-market price to relatively less well-off citizens. The law is prompted by the fear that, if you let such people sell their property, then soon the rich will buy up all such apartments from the relatively worse off. My argument was simply that, if these less well-off people wish to sell their property presumably they will be better off with such sales. So if the government's aim is to help them, the government should allow them to do so. And, in any case, since the buyer also wishes to buy, such transactions are Pareto improvements.

However, someone wedded to both (a) and (b) will run into a difficulty. If some politician wants to stop individuals from selling their property then, by condition (b), the politician must be worse off if people sell their property. Hence, permitting such a sale between a willing seller and a willing buyer is not a Pareto improvement. They are better off but the politician who objects to the sale is, by (b), worse off. So condition (a) ceases to apply. In other words, one can be a Paretian and still permit wanton interference in the market by the government. In brief, if one adheres to (a) and (b), one cannot use the Pareto criterion to argue against "any" government intervention.

Social Conditions

Another underlying issue is that social conditions, which are largely determined by history, matters. Since social conditions are not quantifiable and subject to formal analysis like economic variables, one has to use one's common sense in devising the rules of action. What worked in China may not work in India and what did well in South Korea may backfire in Pakistan. This does not mean that one has to suspend all judgment but that one has to use one's intuition and "feel" to craft policy. Economic policy cannot be reduced to engineering rules. Take, for instance, labour market reforms. On the face of it Pakistan seems to have done it all. India's most contentious labour legislation – the one that makes the laying off of workers difficult – the Industrial Disputes Act, 1947 – became law a few months before India and Pakistan gained independence from Britain in August 1947.

Democratic India made marginal amendments to this law but has not been able to make serious changes. Pakistan's martial leader, impatient about troublesome workers in 1958 in East Pakistan (now Bangladesh) repealed the law and, by the late 1960s, had a much more flexible regulation in place (Amjad 2001). It is however not very clear that Pakistan has managed to derive much from this change of law. Behaviour is partly determined by the law and partly a matter of social institutions and custom. Also, Pakistan's other complementary policies have been inadequate; and Pakistan's economy has steadily lost out to India over the years.

Since Bangladesh was formed out of Pakistan in 1971 it inherited Pakistan's laws and it has also not done well in its labour relations and on other economic fronts. Clearly, while India needs to change the law, the experience of Pakistan and Bangladesh suggest that benefit from such change is not inevitable. There should be effort to make concurrent changes in social institutions. And one needs complementary policies, such as a social welfare support system for workers, though I should emphasise that, even without this, greater flexibility of the labour laws is likely to be of benefit to workers in the organised as well as unorganised sectors.

Market-Enabling Norms

Finally let me comment on social institutions and norms. Much of traditional economics was written up as if norms did not matter. Take, for instance, trade or exchange, which is the foundation of economic interaction between human beings. It is a standard assumption in economics that, if individuals prefer more to less, their preferences are convex and the initial endowments are lopsided, then there will be exchange. But experiments with rats have shown that even when all these three conditions are satisfied rats do not perform trade and exchange.

Clearly, there are other unwritten requirements which are preconditions for trade and exchange. These have to do with social norms – the ability of agents to communicate with one another, the ability of individuals to exercise self-restraint and respect what belongs to others and not try to snatch and take away other individuals' endowments by force (rats do that). In brief, there is a set of "market-enabling norms" which need to be in place before a market-economy can function efficiently (Basu 2000).

This is not a normative observation. Whether or not a norm is morally desirable is distinct from whether or not a norm has properties that help markets function efficiently. In India, the norm of respecting a queue is ill developed. In industrialised nations, when people join a queue, they do not give it a thought, mechanically taking up their place at the end of it. On the other hand, in India, a gap in a queue is viewed as an opportunity, the opportunity to cut in, in the same way that in a marketised economy a rise in demand is viewed as an opportunity – the opportunity for entrepreneurs to raise prices. It is not that one of these norms is "morally" better than the other but not having the queuing norms does hurt the smooth functioning of the economy.

Another example is the norm not to steal. Consider a special case of this – the norm not to steal from the rich. It is not clear that this norm always has moral force behind it. Since the wealth of the rich is at times ill-gotten, to take away from them is not "axiomatically" immoral. Yet it can be argued that not having this norm makes it hard for an economy to function effectively, and maintain high levels of investment and growth. Hence, while this norm may or may not have moral force, it is a critical market-enabling norm.

Once one begins to think hard about norms, one realises that there is a raft of them that needs to be in place before an economy can function effectively and prosper. The role of getting our economic policies right is important for growth, but vastly more important is the need to have the fauna and flora of market-enabling norms in place. Economies and regions have floundered and failed more often for not having such norms in place than because of wrong policies.

Minimal amount of trust, some altruism, respect for rules, are all part of norms that aid markets and development. Chung (2007: 29, column 2) is right when he stresses the significance of certain social and institutional preconditions for South Korea to do even better:

> One can easily see that social safety nets that mitigate workers' fear of restructuring, trust and reputation that facilitate market transactions, and the legal systems that support markets are not easily exported to developing countries. The potential role of this invisible and important part of human interaction should not be underestimated. The social capital of trust, an accepted long-term view, and shared norms that generate a positive environment for everyone are needed to ensure transparency and to guarantee that market principles work properly.

We do not fully understand what all the market-enabling norms are, and how some societies come to acquire them and why others are inadequately endowed with them.[19] An important reason for this lack of knowledge is the economist's prior that matters of social norms, institutions and culture are unimportant for economic development. Consequently this is a field of inquiry that has not been adequately studied.

To sustain the development process that has started up in so many nations, for instance, China, and, more recently, India, and to jump start the process where there has been stagnancy, for instance, large tracts of sub-Saharan Africa, we must combine good economic policy with appropriate social and institutional policies. For the latter we need to step up research in this field, which, by occupying a space in that no-man's land between the traditional disciplines of academic inquiry, has been all but ignored.

NOTES

1 As I have written elsewhere (Basu 2007), many years ago in Delhi, outside the office for obtaining driving licences, a "doctor" offered me a certificate for good eyesight, adding kindly, "irrespective of the condition of your eyes".

2 This is a somewhat awkward moment to be writing this since, starting with the financial crisis and the recession in industrialised nations, a slowdown has spread across most of Asia. India's growth rate of GDP (at factor cost) in 2008-09 has come down to 6.7% (Government of India 2009). However, no matter how this recession works out (Rakshit 2009), the basis of my analysis here, which is focused on history and long run trends, is unaffected.

3 What is unquestionably true is that China has followed an open door policy since the late 1970s. For an engaging analysis of this that delves into the ideological ambiguity of this policy, see Deshpande (1998).

4 In his insightful analysis of China's recent success, Yao (2008) recognises the role of pre-1978 in what happened after that. He points to the significance of a more equitable distribution of income that was achieved during early communism in China. According to him, this also dampened factional or class interests within China, which can be destabilising. Greater income equality usually goes together with greater literacy and better health provision. China made huge strides in these before 1978, thereby setting the stage for the surge in economic growth that would come a little later (Sen 1998).

5 The figures for 2005-07 are from the IMF *World Economic Outlook* database, cited in Burton and Zanello (2007). The figure for 2008 is based on an estimate from the Ministry of Finance, Government of India. For the financial year 2008-09 the growth rate is expected to go down to 7.1%.

6 For recent comparative studies of inequality in India and China, see Bardhan (2008) and Chandra (2009).

7 See also Prestowitz (2005) and Khanna (2007).

8 In varying degrees, there is novelty in the growth experience of both China and India, as is illustrated amply in Khanna's new book (Khanna 2007).

9 The baffling nature of contemporary Chinese capitalism is marvelously described in a recent book by Huang (2008). The control of some Chinese corporations are so intertwined between the government and the private that it is impossible to unambiguously classify these corporations as either state-owned or private.

10 One reason for disagreement on what caused China's growth is the choice of benchmark. If we compare the China of the 1990s and even today to the China of the 1960s or early 1970s, there is no doubt that there have been huge pro-market reforms. This is catalogued very well in Yao (2008). Yet, my argument is that, if we compare the level of control the state continues to exercise over the economy – from the ownership of agricultural land, through movement of labour to the ownership of firms – in China with certainly market economies but virtually any economy, China turns out to be one of the most state-controlled economies in the world. To that extent its economic success does not fit comfortably the models encountered in economics textbooks.

11 For an excellent analysis of the Maoist roots of the supposedly pliant nature of Chinese labour, see Riskin (1973).

12 The president of Peking University, Ma Yinchu, was not only silenced but lost his job over this in the 1950s.

13 For an analysis of uprisings through the country's early history, see Wong (1997).

14 Singapore may be an exception to this. It has on occasions has had savings to rival that of China.

Interestingly, Singapore is also a case of an economy, led by the strong arm of government (see Hong 2008), even though in terms of direct state-ownership of enterprise and corporations, it does not come anywhere near China.

15 For an analysis of India's reforms and recent growth performance, see Ahluwalia (2002), Basu (2004), Rodrik and Subramanian (2004), Srinivasan (2005), Basu (2006a, 2008) and Panagariya (2008).

16 Even as I write this, both these indicators – foreign exchange reserves and the fiscal deficit – have taken a turn for the worse because of the global financial crisis. I am however inclined to treat these downturns as temporary and the improving trends to resume once the crisis is over.

17 It is worth mentioning that there is an enormous amount of inter-regional policy variation in China. The land-locked hinterlands have tended to be more state directed, whereas the coastal provinces have been more market driven (Nee, Kang and Opper 2009). However, even the most market-driven areas continue to be more state-controlled than most other nations in the world.

18 For an analysis of changes in poverty and inequality in India, see Deaton and Dreze (2002).

19 There is a small literature in economics on how some norms can be nurtured or mitigated through appropriate interventions. Aldashev, Chaara, Platteau and Wahhaj (2009) provide interesting theoretical constructions of how the law can be instrumental in influencing norms.

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