



University of Nevada, Reno
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Economic and Financial Market Developments in China and India

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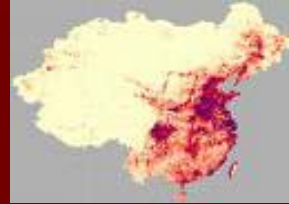
The **People's Republic of China** is currently the sixth (or possibly even the second) largest economy in the world, with the world's fastest growth rate and its largest population.



It is also still an economy in transition from a poor, rural command economy to a dynamic and prosperous market economy, with a stark contrast between a large and mostly poor rural population, and relatively advanced, westernized, and wealthy cities.

Geography and Population

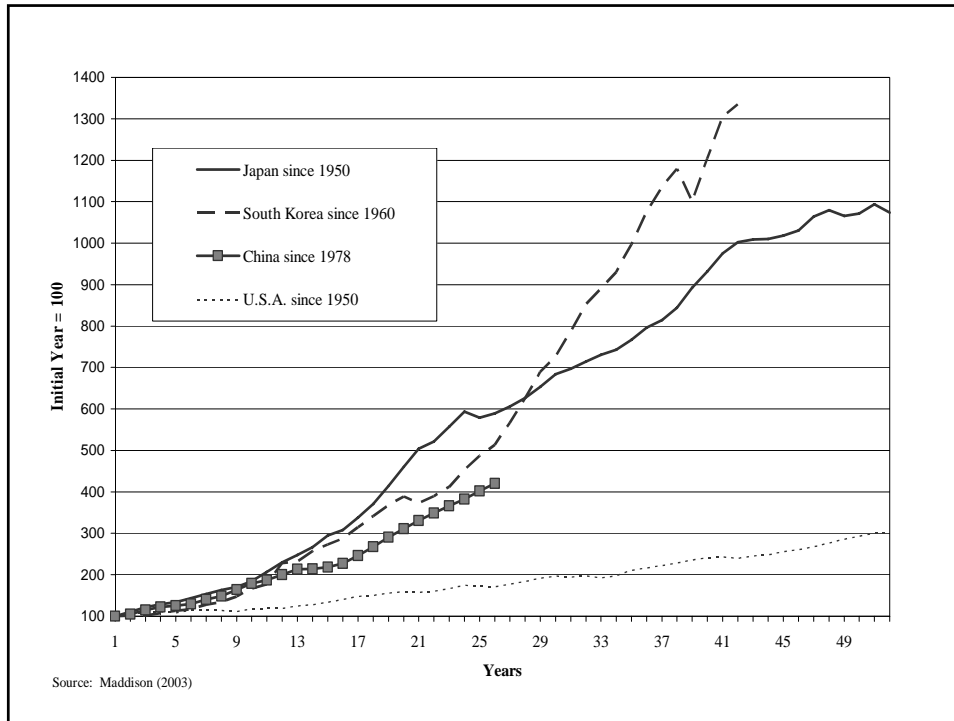
- China's population is 1.3 billion people (currently growing at only 0.6% per year), with 58% in rural areas and most of the people in the east.
- China's land area is roughly 3.7 million square miles, compared to 3.5 for the USA (including 0.6 in Alaska).
- China's average population density is more than four times that of the USA.
- China has a less arable land than the USA, so the density per unit of arable land is almost nine times that of the USA.



China's GDP

- In 2004, China's per-capita GDP was 10,500 *Renminbi* (or Yuan). At the official exchange rate, this was roughly \$1,300. Adjusting for purchasing power parity and updating to 2006, the CIA estimates that China's per-capita GDP is roughly \$7,600 (compared to \$43,500 for the USA).
- China's real per-capita growth rate since 1978 has averaged roughly 8% per year. This is currently the fastest in the world, but is not as fast as Japan (1950-1975) or Korea (1960-1990).
- Assuming the PPP numbers are accurate, then IF China could maintain this growth rate, it will become the world's biggest economy by 2012 and the richest per-capita by 2040.





Major Cities and Provinces



- The capital *Beijing* is China's most modern city, with 15m. people and a per-capita income of 37,000 RMB (\$4500) in 2004.
- *Henan* province is the most populous (97m.), followed by *Shandong* (92m.) and *Sichuan* (87m.).
- *Jiangsu* province is China's largest industrial producer.
- *Shanghai* is the largest city (17m.) and the richest (60,000 RMB or \$7200 per capita).
- *Guangdong* province (83 m.) has the largest overall GDP.

China's Foreign Trade and Investment

- In 2004, China was one of the world's biggest trading nations:
 - the world's fourth largest exporter, after Germany, the U.S.A., and Japan.
 - the world's third largest importer, after the U.S.A. and Germany.
 - accounts for 6% of world exports and 5% of world imports.
 - receives 4% of U.S. exports and provides 11% of our imports.
- In 2006, China received \$70 billion in Foreign Direct Investment. China is the largest recipient of FDI in the less developed world. It was also technically the largest recipient in the world, but this amount included amounts from Hong Kong. After HK, the U.S.A. is the largest investor in China.

China's Labor Force



- The average wage was approximately 16,000 RMB/year (6400 in farming, 11,000 in manufacturing, about 20,000 in finance, research, and foreign-owned firms).

In 2004, China's official labor force was roughly 770 million people.

- 490 million were employed in rural areas (140m in township and village enterprises, 20m in private firms, 21m self-employed, and more than 300m million in agriculture).
- 265 million were employed in urban areas (67m in regular state units, 14m in LLCs, 6m in listed firms, 30m in private firms, 10m in foreign-owned firms, and 25m self-employed).
- Estimates for the "floating population" of informal rural-urban migrants are as high as 100 million people.

Education

- Literacy rate is roughly 90%.
- China has more than 30 million new high school graduates per year, plus 2.4 million traditional college graduates, 1.9 million returning adult graduates, and 150,000 advanced graduates.
- The most popular majors for advanced graduate study are engineering (37%), management (12%), science (12%), medicine (11%), and law (7%).
- China's exports have typically been concentrated in labor-intensive products that used to be produced by other Asian countries, but China is starting to move into more higher-tech areas.
- China's government is making a major investment in its universities, attracting back professors from top-ranked schools in USA and elsewhere. Qinghua, et cetera.



Governance

- China is run by the Chinese Communist Party, and there are separate and parallel political structures for the party and the state. Provincial/municipal governments are appointed by the central administration.
- *Chief of State* is President HU Jintao, who is also General Secretary of the Chinese Communist Party. Appointed by the National People's Congress to a five-year term, up to two terms.
- *Head of government* is Premier WEN Jiabao, also appointed by the NPC, together with the entire *State Council*.
- China's appointed leaders are all members of the CCP, as are most representatives to the NPC.



China under Chairman MAO Zedong

- October 1, 1949: PRC founded by Mao. Not recognized by USA.
- Soviet-style nationalization of industry in 1950s, gradual collectivization of agriculture.
- Great Leap Forward (1958-60) led to world's worst famine.
- Cultural Revolution (1966-76) led to breakdown of education, public order, and planning. Radical policies, extreme uniformity continued until Mao died (1976).
- China re-established relations with the USA in 1970s.



DENG Xiaoping

- DENG Xiaoping emerged as "paramount leader" in 1978 after his proteges (HU Yaobang, ZHAO Ziyang) were elected to highest positions.
- End of "Politics in Command."
- Political restructuring to end personality cults, including term limits.
- CCP repudiated Mao's policies without repudiating Mao.
- Pragmatic "black cat, white cat" approach.





Deng's Economic Reforms

- ❑ Open Door Policy : Joint-Ventures, Special Economic Zones, tourism, et cetera. China granted "MFN Status" by USA.
- ❑ Rural Reform: Decollectivization, rural and urban markets, new rural township and village enterprises, and the release of surplus labor.
- ❑ Industrial Reform: Decentralization, more autonomy for state firms and provincial governments, profit retention, two-tier pricing system, banking reforms, et cetera.
- Result: State firms became more productive, but also were freed to get more investment than they could productively use: more competition, poor management, less profit.

The Socialist Market Economy, 1992 –



- Under President JIANG Zemin, the CCP renounced the idea that economic reform was just a temporary stage.
- Instead, the new policy was to create a developed market economy with the CCP in charge. State firms would be the "cornerstone" but not necessarily the dominant type of firm.
- To promote trade, the currency was unified and devalued to the black market rate. The current account became "convertible".
- Most state firms were transformed into LLCs, and the best could raise money by going public – though the state retained a controlling share.
- State banks were split into commercial and policy banks.

China's Changing Industrial Structure



- New Chinese private firms, wholly-owned foreign firms allowed, but these have little access to financial sector. Private entrepreneurs allowed into CCP under "three represents" policy.
- Policy of "release the small, retain the large" for SOEs, leading to layoffs in 1990s and creating Korean-style firms.
- Export sector dominated by TVEs, foreign-owned firms, private firms; relied upon to deal with urban unemployment problem.

China's entry into the



- China was an original member of the GATT, but this seat was kept by Taiwan after the civil war until the 1970s.
- China was given MFN status under the Jackson-Vanik amendment, but this required an annual review of its human rights record.
- China was finally admitted into the WTO (along with Taiwan), and agreed to open its import, telecommunications, and banking sectors to foreign competition and investment. Chinese tariff rates came down dramatically.
- China is seen by many as dragging its feet, especially in banking, but this year the sector is starting to open more.

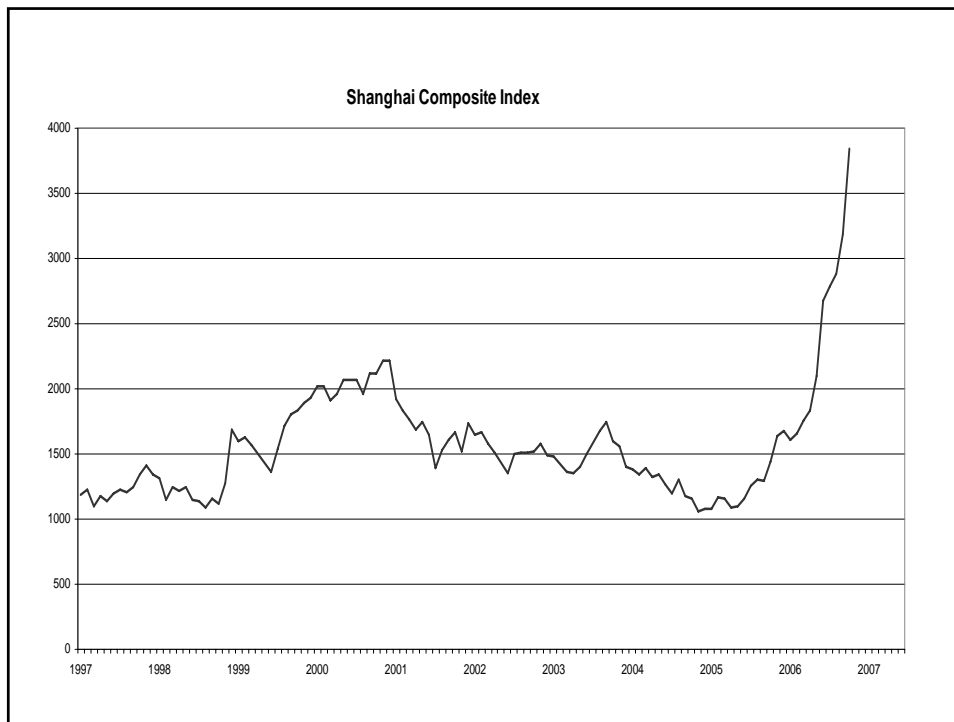
State Banking



- China has four big state-owned banks, two of which now are partially owned by private owners, plus a number of other smaller national and city banks.
- Local governments have had influence over bank lending, and loans have been biased towards state firms.
- Banking is poorly regulated, and there have been a number of major cases of bank officials absconding with or diverting very large sums.
- Banking has had a high non-performing loan ratio for the past decade or more, and under Premier ZHU Rongji the gov't tried to address the problem, with mixed results.
- China has a *very* high savings rate, and deposits remain in state banks due to implicit state guarantees.

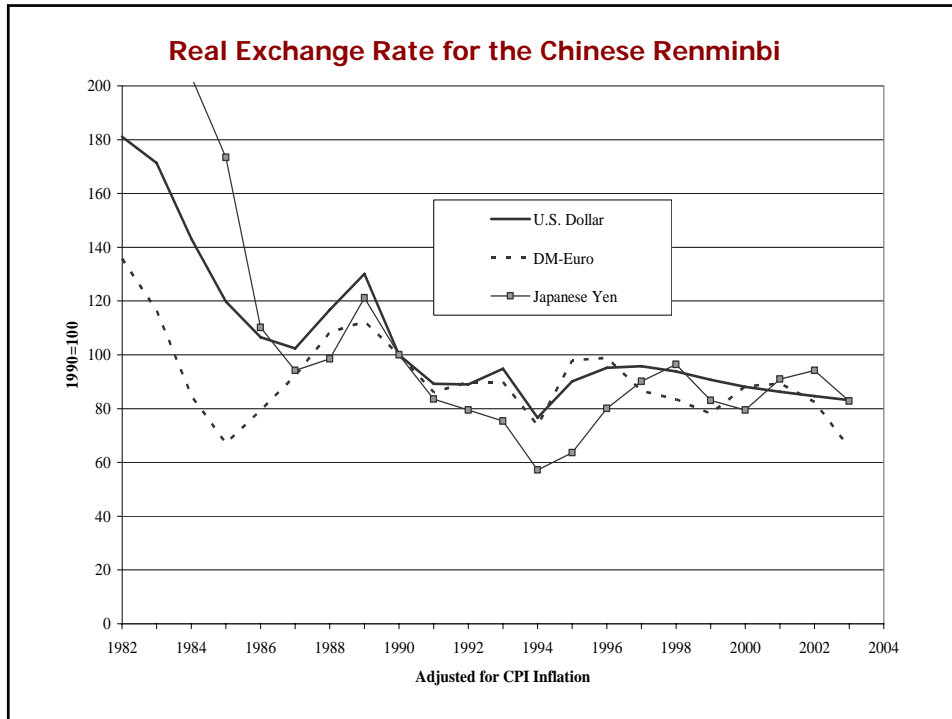
Stock Markets

- Shanghai Exchange created in 1990, Shenzhen in 1991.
- Foreign investors segmented into B shares market (USD in Shanghai, HKD in Shenzhen) – Forex capital transactions are still not convertible.
- Only state's best performers initially allowed to list, but state still controlled a majority of shares – stocks a way to raise capital from public without privatizing.
- Market capitalization 26% of GDP in 1997, 30% in 2005.
- Market stagnant from 2001-2006, then bubble began. Shanghai Composite Index has risen 167% in the last year, as Chinese consumers look for higher returns.
- P/E ratios twice as high in Shanghai than HK, for the same firms.
- Cheng: 70% of listed firms really bankrupt, should be delisted.



China's Exchange Rate Controversy

- China pegged RMB to the Dollar in 1994 at the black market rate, which made China's exports even cheaper. Currency had been considered overvalued.
- China's inflation rate has been lower than ours since 1997, and the currency has become more desirable.
- China now accounts for more than 10% of U.S. imports, and is blamed in USA for loss of manufacturing jobs. The USA has lost 2 million manufacturing jobs since 1995, while China has lost 16 million.
- China runs a large current account surplus with the U.S. but a deficit with the rest of the world. Net trade surplus plus financial account surplus → BOP surplus.



Will the Currency Appreciate?

- Exchange rate kept low through massive purchases of U.S. Bonds by People's Bank of China, which now holds more than \$1 trillion of US government debt.
- Foreign exchange reserves have financed money growth, but this has been met (so far) by rising money demand.
- Expectation of future appreciation provides implicit insurance for those holding Chinese assets.
- China now pressured to allow currency to revalue or even float, but this is dangerous to banking sector. Alternative may be price inflation from BOP surpluses.
- China has begun to give more weight to other currencies, and in the past year or more has allowed the RMB to rise from 8.29 to 7.71 per Dollar. Much more still expected.



Rural China

- Most Chinese still live in rural areas, on less than \$2 per day.
- Rural areas continue to have large surplus labor problem, and many worry about effect of U.S. agricultural imports on farm prices.
- Reports of many protests by farmers over extractive rural leaders.
- Recent experiments in local elections.
- Widening poverty gap between rural and urban areas.



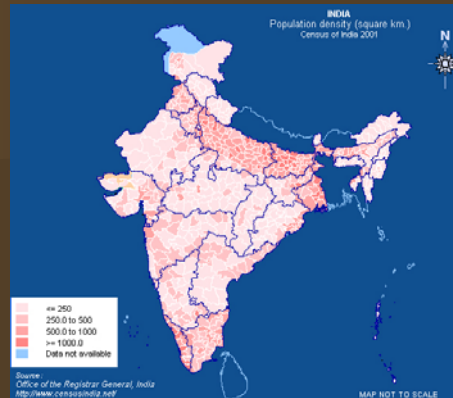
Part II: Developments in the Republic of India



- World's largest democracy.
- Federal Republic, bicameral parliament, new prime minister (Dr. Manmohan Singh, Congress(I) Party) is head of government.
- 81% Hindus, 12% Muslims, plus Sikhs, Nestorian Christians, Buddhists, etc.
- Legal system based on British common law, with judicial review of legislative acts, but with separate personal legal codes for Hindus, Muslims, and others.
- 25% below poverty line, growing middle class (about 33%).

Geography and Population

- India's population is 1.1 billion people (currently growing at 1.7% per year). Will catch up with China by 2050.
- Roughly 30% of population is in urban areas.



- India's land area is roughly 1.1 million square miles, compared to 3.5 for the USA, but 49% is arable (versus 18% for U.S.). India's arable land is thus equal to U.S.
- India's average population density is almost 12 times that of the USA, but only 4.3 times as much per unit of arable land.

- In 2006, India's GDP was per-capita GDP was \$800 billion (or \$4 trillion at purchasing power parity estimates). This is roughly \$730 (or \$3700) per capita.
- Income per state varies widely. Goa has ten times the average income of Bihar.
- India's real growth rate since 1992 roughly 6.2% per year (4.5% per capita). About 7% in 2005, and in 2006 expected to be 8.5%. Fast by India's historical standards, but not as fast as China.
- Rapid growth in both services and manufacturing.

India's GDP



Educational Advantages

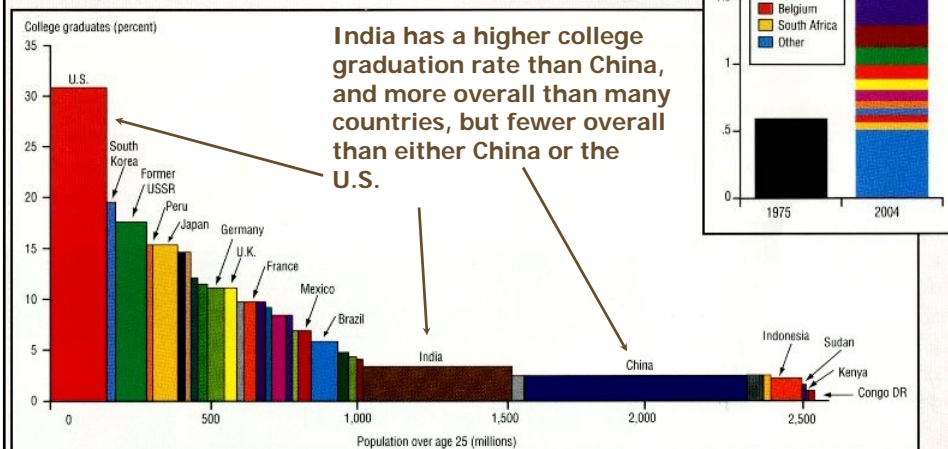
- English the most important language for national, political, and commercial communication. Hindi is the national language, but spoken primarily by only 30% of population. Hindustani a common dialect. Other official languages include Bengali, Telugu, Marathi, Tamil, Urdu, Gujarati, Malayalam, Kannada, Oriya, Punjabi, Assamese, Kashmiri, Sindhi, and Sanskrit.
- Indian education based on British system. Very good universities, college graduation rate slightly higher than China.
- Internet and fiberoptic cables connect coastal India to global economy, now allowing access to U.S. market.

More Seek Knowledge Abroad...

The number of students studying overseas more than quadrupled in the past four decades (*right*). The U.S. led, with 22 percent of the foreign students in 2004.

...but Educational Gaps Still Large

While the U.S. educates more foreigners than any other country, it still leads the world by a large margin in college graduates as a share of its own adult population (*below*).



Indian Independence

- Independence movement led by alliance of Indian National Congress (Jawaharlal Nehru, Mohandas Gandhi, Netaji Bose) and Muslim League (Muhammad Jinnah).
- Independence granted by British in 1947 (East and West Pakistan were partitioned).
- India became a federal republic in 1950.
- Congress Party dominated politics, and Nehru family dominated the Congress Party:
 - Nehru prime minister until 1964, Indira Gandhi prime minister 1966-77, 1980-84 (assassinated after attack on Sikh-held site in Amritsar); Rajiv Gandhi 1984-1991 (also assassinated).
 - Hindu Nationalist Party (BJP) competitive after 1991, Sonia Gandhi led Congress(I) Party to victory in 2004.



India's Democratic Socialism

- Mohandas Gandhi advocated not only *Satyagraha* (nonviolence), but also *Swaraj* (self-rule). After his assassination in 1948, Nehru favored Gandhi's principles of self-reliance, appropriate technology, nonviolence, and egalitarianism.
- Nehru influenced by British "Fabian socialism," and impressed by Soviet planning. More democratic, non-revolutionary approach favored political democracy and secular nationalism.
- Indian Planning Commission established 5-year plans: indicative, not directive.
- Private industries under "License Raj" – size limited to prevent monopoly power, rents paid to government.
- New SOEs created under Nehru, nationalization of firms expanded under Indira Gandhi's reservation system. By 1991, SOEs accounted for 24% of GDP.
- Still, no comparison to China: central government expenditures only accounted for 14% of GDP.

India's Turnaround

- After Rajiv Gandhi was assassinated in 1991, new government (Singh was finance minister) faced balance of payments deficit, budget deficit, inflation, foreign debt repayment problem, and financial crisis.
- IMF Conditionality for loans led to dramatic reforms:
 - Reduction of budget deficit and inflation.
 - Opening to foreign trade and investment.
 - Private firms allowed to compete more with SOEs (but still heavily regulated).
 - Banking gradually deregulated, but state-owned banks still dominant.
 - Continuing problems in SOEs: subsidies expensive, performance weak (e.g., electricity industry).

Major Cities



- The capital *New Delhi* has (with old Delhi) 10 million people (17 in the metro area).
- *Mumbai* (Bombay) has 12 million people, and is one of largest cities in the world. It is India's financial capital.
- *Kolkata* (Calcutta) has 5 million (11 metro).
- *Bangalore* (4 m., 6 metro).
- *Chennai* (Madras) has 4 million people (7 metro).

Foreign Trade and Investment

- ❑ India was relatively closed and protectionist before 1992.
- ❑ After 1992, Rupee was devalued, then floated.
- ❑ Tariffs and NTBs dramatically reduced (now 12.5% average), rules on FDI relaxed.
- ❑ Trade ratio rose from 18% to 26% by 2004.
- ❑ India currently running current account deficit, offset by foreign investment.
- ❑ Reserve Bank of India has increased its foreign reserves by 35% per year since 2001, keeping Rupee from appreciating too much. Now 2.5 cents (40 per Dollar), was 2 cents (48) in 2002. Rising slightly now.
- ❑ Import competition improved quality of domestic goods, export competition opened opportunities for comparative advantage.

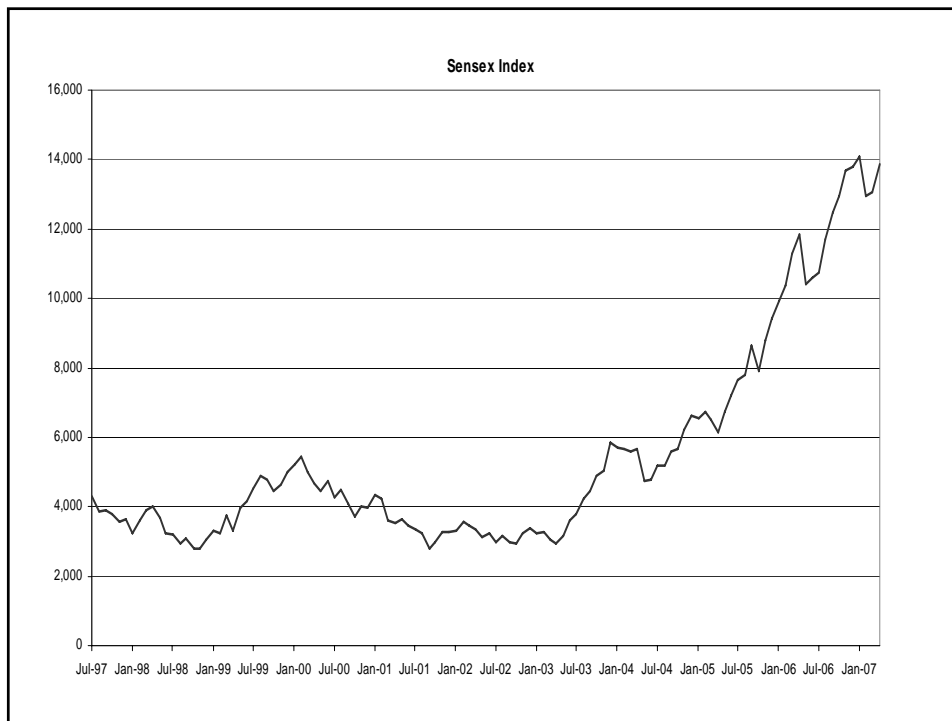
Investment in India

- Investment almost 30% of GDP (twice the U.S., but less than China).
 - Foreign investment low before 1992, focused on equity investment in 1990s.
 - Foreign direct investment tripled to \$16 billion in 2006 (still less than a fourth of what China received).
 - Legal system protects property rights, but more democratic government means that things can move slower, plus more "bureaucratic hurdles."
- 
- AT Kearney: India is the best place to start a business.



Financial Markets

- India's financial system remains under tight government control. Regulation creates large spread.
- Interest rates are currently much higher than in China (for borrowers).
- CPI inflation rate is 4%, but has recently risen to 6%, and central bank is expected to tight money growth.
- Mumbai stock market goes back to British Raj. Sensex and other indices (e.g., Nifty Fifty) have increased by a factor of four in the last four years (45% per year).



Indian Financial Stability

- Like China, India survived Asian Financial Crisis in 1997 relatively unscathed.
- India had already implemented reforms, the Rupee had floated, the international capital account was not fully convertible, and the amount of foreign investment (and debt) was relatively low.



A Comparison of PPP *Per-Capita* Growth Performance (1-2000 based on Angus Maddison's PPP estimates)

Years	India	China	Ending Ratio
1-1820	0.0%	0.0%	89%
1820-1870	0.0%	-0.2%	101%
1870-1900	0.4%	0.1%	110%
1900-1950	0.1%	-0.4%	141%
1950-1970	1.7%	2.9%	111%
1970-1990	2.1%	4.4%	70%
1990-2000	3.7%	6.2%	55%
2000-2005	5.0%	8.9%	46%