International Journal of Applied Research 2020; 6(2): 333-337

ISSN Print: 2394-7500
ISSN Online: 2394-5869
Impact Factor: 5.2
IJAR 2020; 6(2): 333-337
www.allresearchjournal.com
Received: 25-12-2019
Accepted: 27-01-2020

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India, china and the socio-economic determinants of their competitiveness

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Abstract
The People's Republic of China and the Republic of India are not only the two most populous states in the world, but also two of the fastest growing economies in the last years and increasingly important engines of the globalized economy. China has been growing with nearly two-digit rates since the first reforms in 1978 and is the world-leading receiver of foreign direct investment today. Since 1980, India has been generating an average real growth of 6% per year, constantly surpassing the 8% landmark since 2003. In the years to come, economists still expect growth rates above the global average. This Paper is a modest attempt to study the Socio-Economic determinants of competitiveness between India and China.

Keywords: Competitiveness, socio-economic determinants, trade liberalisation

Introduction

For these reasons, there are a large and steadily growing number of (popular) scientific publications on China and India asking why both countries have become increasingly competitive, denoting them as giants on the rise. Communalities as their immense population, economic dynamics, or geography are seductive to pigeonholing both countries and looking at them without sufficiently taking into account the complexity of such a comparison. The apparent differences between both countries and their unique characteristics can teach important lessons though. In addition, discussion is largely focused on the prognosis of growth rates.

Important factors that determine the economic performance of China and India Have only lately entered the discussion on the factors that make a country internationally competitive or not central traits of its society, cornerstones in history, or its cultural shape. Starting with the discussion why pure economic determinants cannot solely explain a country's competitiveness, we will give an overview of the general development of the two countries considered and present common indicators of competitiveness. Then, we will analyze previous qualitative research and evaluate quantitative data to assess which country has more favourable socio-economic factors influencing its economic performance in the long run. Finally, the paper offers a tentative prognosis whose socio-economic determinants are more conducive to long-term economic success.

Competitiveness and Its Determinants

When discussing competitiveness, problems start with trying to define the term. Neither in theory nor in praxis there is a common definition of the term competitiveness. In particular, problems occur when trying to define the notion of competitiveness of a country whereas the definition on a microeconomic basis is widely acknowledged. An enterprise is said to be competitive if it is able to improve the quality of its products above average or to reduce the costs of its production to an extent that it can enlarge market share or profit compared to its competitors.

On a national basis, however, competitiveness cannot be defined simply in analogy to the microeconomic notion. The distinction then is much more difficult. The OECD defines competitiveness as the extent to which a nation is able to produce goods and services that can be traded on international markets under the conditions of free trade and just market conditions simultaneously to an increase of the real income of the inhabitants (OECD, World Competitiveness Report 1997).

The cornerstones free trade, competition, economic growth, and the ability to increase the sales of own products on international markets are also applied by other attempts to define competitiveness depending on focus, further aspects of competitiveness are added. Fagerberg (1988) [7] sees competitiveness as the ability of a country to realize growth and employment while simultaneously avoiding imbalances in the balance of payments. According to Newall (1992) [8], the successful sales of domestic products on national and international markets shall contribute to improve the infrastructure of social services and support the socially weak.

Even more difficult than a definition of the term competitiveness is a categorization of the determinants that may explain whether a country is competitive or not. If understood as growth, neoclassical and endogenous growth theory can provide insights into the determinants of competitiveness. Neoclassical growth theory emphasizes the role of accumulation of human and physical capital for the long-term development of an economy. The higher the investment of a region in its stock of capital, the higher the level of regional income per capita. But this impact of investment on growth reaches a border, continuous growth can only be achieved by technological progress. Technological progress, however, is not endogenous in the model, Solow (1956) [9] and has only been included in exogenous growth models, explaining the determinants of technological progress. In most models, technological progress is the result of the private sector's research and development efforts. This idea goes back to Schumpeter who considered growth on a microeconomic level and the meaning of enterprises for the growth cycle. But to develop a model of endogenous growth on an aggregate basis, all enterprises need to show identical production functions have the same stock of capital and labour force. That is a strong discrepancy to the proposed recurrence to the assumptions of microeconomic theory that are needed to formulate a theory of endogenous growth. The presentation of entrepreneurial conduct that is conceived to be the determinant of growth thus becomes highly stylized and draws an inappropriate picture of entrepreneurial decision making. Furthermore, growth theory is not a sufficient concept when looking at international trade flows. Most growth models are models of closed economies, immobile factors of production are assumed and the trade of goods and services is widely neglected.

The aspects of trade are the issue of the traditional and the new trade theory. In traditional trade theory, going back to Adam Smith and David Ricardo, countries are equipped with different production factors which are used by trade in the form of comparative advantages. In the framework of international work sharing, nations specialize on products in production, the production of which as comparative advantages. Efficiency gains generate higher growth rates. Through international free trade the factor costs for labour and capital adjust and the resources of single countries complement each other.

On polypolistic markets, identical investment rates and equal access to technological knowledge assumed for every economy, growth again, according to the neoclassical convergence hypothesis, is determined only by population growth and technological progress. Underdeveloped countries then catch up to developed economies. The traditional model of trade in tradition of Viner, however, suffers from an important short coming: The trade structure of the integration partners is necessarily asymmetric. The results of the analysis are thus dependent on the assumed specific trade pattern. Furthermore, the barriers of neoclassic theory as an explanation for competitiveness may be seen in the fact that in reality, important assumptions are hurt, such as homogenous products, homogenous factors of production, polypolistic markets, or limited capacity of production. Changes in economies of scale and the degree of competition on incomplete markets are neglected. In addition, these models do not offer an explanation why enterprises are able to develop competitive advantages both through trade and foreign investment and why they are able to defend their advantages for long time periods. The new trade theory shows that profits can be gained from trade independently of the existence of comparative advantages.

On markets of monopolistic competition or in oligopolies, trade liberalization and an extension of domestic markets may lead to a more intensive use of economies of scale and increased competition from the viewpoint of a single enterprise. Increasing economies of scale may lead to a specialization of countries and regions, even if there are no differences in the equipment with resources or technology. Savings and thus competitive advantages then derive internally from the size of an enterprise and externally through the size of a branch or industrial agglomeration. In the latter case, positive externalities lead to further cost reductions and efficiency gains. The new trade theory adds to the neoclassical concept of comparative advantages the aspect of incomplete markets.

However, the determinants of competitiveness in fact lie on the level of entrepreneurial behaviour. Schumpeter realized that entrepreneurs create technological and financial progress to survive in a framework of increasing competition and declining profits.

Innovation is one main factor of entrepreneurial activity. To analyze why entrepreneurs are innovative, an immensely stylized theoretical framework as in growth and trade theories appears to be insufficient.

Jump Start of the Giants

Today, China and India are outstanding. In fact, China had been outstanding before. In the year 1600 AD, the Chinese empire was the greatest and most developed among all unified empires in the world. At the same time, Russia had only started growing together, India was scattered between Mogul and Hindu reign, and the giant empires of Mexico and Peru had fallen. Yet, more recent history did not show such a positive picture, neither for China nor India. Soviet type socialism in China and import substitution policy, banning India in economic backwardness, was yet replaced by opening for foreign direct investment and export-led growth, respectively. These market-oriented reforms allowed for the rise of the Asian giants since the 1980s and shall briefly be summarized.

In the first years of the People's Republic of China, economic development was ambivalent. Between 1952 and 1975, GDP grew on average by 6.7% on an annual basis, yet consumption stagnated. Education, social security, and medical care were improved, and the share of industry in total output grew from 20 to approximately 45%. This development was largely based on mobilization of additional human resources while investments in capital stock became more and more inefficient. Only Mao's death in September 1976 and the takeover of Deng Xiaping in 1978 opened a gateway for reforms that were responsible for the economic jump start.

The start of reforms in China is commonly dated the XI Congress of the Communist Party of China in December 1978. Neither precise reforms were concluded nor a time schedule was elaborated, yet there was an ideological change. Deng Xiaping's pragmatism won over Maoist dogmatism of Hua Guofeng; economic development was declared as the primary goal of party policy. After the Cultural Revolution, China had fallen behind its Asian neighbours; now, reforms of a gradual and experimental nature were initiated that targeted agriculture, creation of private enterprises, and restructuring of state enterprises and, most importantly the opening of the economy that attracted foreign direct investment and hence facilitated technology transfer.

In 1978, China was fairly isolated from East and West and hence one of the least open economies in the world. Foreign trade accounted for only 14% of GDP in 1978 whereas world average was 34%. In 1979, however, central government decided to extend foreign trade and allow foreign direct investment. Two provinces were chosen to experiment with these reforms; in 1980, four special economic zones were created—Shenzen, Zuhai, Shantu and Xiamen—that were granted various privileges. For example, projects for foreign direct investments up to USD 30 million could be granted independently. Market institutions and private property were tolerated here. Today, these four regions are gravity centres that bind factors of growth. Positive effects of foreign direct investment can be found here, supported by capitalist local governments that foster market institutions and industrial infrastructure and thus new investments.

Whereas in the Eastern Chinese autonomous region Xinjiang or in the Central Chinese province Qinghai, state enterprises are responsible for more than 70% of industrial production, this share is less than 20% in Jiangsu, Zhejiang, Fujian or Guangdong.

During the third plenum of the XXIV Party congress in November 1993, the most important decisions were made with regard to a modern system of enterprises. The concept of socialist market economics was filled with a rich reform agenda that became the basis of following reforms. Yet only in September 1997, a real breakthrough with regard to property rights was achieved during the XXV party congress, when private property was declared an important component of economy while state ownership was reduced from a major part of economy to one pillar of economy. In March 1999, private property as an important component of socialist market economy was included in the Chinese constitution. The reform process was finally crowned with WTO accession in 2001.

In India, average annual growth between 1950 and 1980 was only 3.7%. Poverty and social inequality as well as the lack of education were not overcome. In the era of Indira Gandhi (1966–1977), encompassing regulation (licence raj) was created and huge parts of the financial sector and external trade were nationalized. When she tried to nationalize the essential trade of grains, the climax of Indian isolation was reached. It was her son Rajiv Gandhi that initiated deregulation and liberalization. Even though these reforms were hesitant, his reign was the start for improving development.

First steps of liberalization were made since 1980 and accelerated in 1985, even though they lacked stringency and received little attention. Imports, especially imports of machinery and raw materials that were not produced in India, were more and more liberalized. Incentives to export have been created especially since 1985. With regard to the domestic market, the number of industries working under governmental license was reduced by 31 sectors, even though important branches such as steel, coal, textiles, and chemicals remained under governmental control. Nevertheless, huge enterprises were usually subject to many restrictions and could not benefit from these measures of liberalization.

Yet, the threshold for being a huge enterprise was lowered, so that approximately half of all huge enterprises were no longer classified as such. Devaluation of the rupee contributed to high exports during the late 1980s. As a summary, those reforms have facilitated access to foreign technologies and capital goods, strengthened competition and enlarged the possibilities for entrepreneurial actions. The fact that relatively small internationally merely recognized reforms have had such an effect has been explained by DeLong (2003)[10] with the help of the conducive institutional, political, and cultural environment. As a country with such relatively good political and economic institutions, a more or less working legal system, cultural values oriented on education, and democratic constitution, India was far below its long-term growth potential in 1980. Hence, small steps could have great consequences. Yet, regional inequality remained enormous, and the industrial sector was lagging behind significantly, having negative effects on aggregated growth. After all, first steps of deregulation and liberalization were tentative. It was only after the breakdown of communism in Eastern Europe and a heavy crisis rooted in the balance of payments that an encompassing reform program was initiated.

Socioeconomic Determinants of Competiveness

Max Weber in his 1904 classical treatise “The Protestant Ethic and the Spirit of Capitalism” was the first to investigate the relation between culture and economic development. Weber argued that Calvinist doctrine of human predestination demanding commitment to work and social dedication and at the same time applying economic success as the benchmark of divine mercy fostered economic development. In his later work, Weber postulated a negative connection between Asian Confucianism and the development of capitalist economic structures.

In more recent past foremost, new institutional economics picked up this approach and acknowledged the relevance of informal path-dependent social systems of rules and norms for a successful industrial development. In contrast, other economic schools of thought neglect the influence of social values on economic performance. Neoclassical theory assumes that economic actors behave rationally and maximize profits. However, vast empirical studies prove that mostly this is not the case, and also that cultural factors can result in different economic behaviour. The reason why cultural factors nevertheless only rarely form part of economic models is due to problems of measurability. Cultural factors are not easily separated from other determinants, so that the exact fraction of economic performance that is owed to sociological elements can hardly be determined Camerer (2003) [11].

The following paragraphs will compare and evaluate the manifestation of cultural values and norms in China and India. By focussing on the development of social capital and the analysis of the political-economic orientation, two especially influential sociological factors will be analyzed. The results will be used to derive implications for the international long- term competitiveness of both countries.

Norms and Values

Culture develops through historical and religious influences and the daily interaction within a society. Cultural factors are thus a dynamic variable that continues changing over time. This process however develops slowly, so that cultural manifestations have long-term meaning.

Chai and Royargue (2003) [12] that China's cultural heritage tends to favour modern economic development more than does India's. The values of Chinese Confucianism emphasize the importance of education, integrity, assiduousness, and mutuality—virtues conducive to economic development.

Indian Hinduism, in contrast, claiming divine salvation by asceticism, promotes individualism and undermines the yearning for material wealth and economic success as well as the accumulation of savings. The abjuration of all earthly wealth that was claimed by Ghandi as well does not favour economic progress.

In addition, the caste system, though officially abolished by constitutional decision in 1949, but still present in everyday life, influences economic activity negatively since it limits the freedom to choose a profession and the chances of cooperative behaviour and sets negative incentives, given the impossibility of social advancement Chai and Roy (2003) [3, 6]. However, there are signs that the rigid social system slowly softens: Wipro-boss Azim Premji is Muslim, Narayana Murthy, and chief of the second largest Indian software enterprise Infosys Technologies, comes from a lower caste. Competition and a new ethic in the multicultural metropolis Bangalore that is captured by a secular spirit more than other urban centres repel religious identity and stress economic success.

Both countries share reluctance concerning external influences rooting in historical experiences of foreign occupation. Even after independence, this attitude manifested itself in a far-reaching isolation from the global market. Paired with desolate infrastructure, this is one factor accounting for the comparatively low level of foreign direct investment.

Conclusion

China and India are two rapidly growing economies, similarly fascinating economists, politicians, and the general public. The dynamic development of the two giants not only forces established economies to adapt their economic framework to the newly emerging competitive environment but also encourages other emerging nations to study and imitate the underlying patterns of success.

In addition to the successful economic reforms since 1978 or 1980, respectively, socioeconomic factors such as cultural values, the accumulation of social capital and the existence of social networks are an important impetus of long-term international competitiveness and economic development. Therefore, conditions and formation of socioeconomic factors in China and India were compared.

Both countries profit from cultural values conducive to economic development as, for example, appreciation of work and education. However, both nations lack social capital. In India, this is due to a pluralist society and the archaic caste thinking. This problem is not easily accessible for policy measures. Although the government tries to promote contracts between all social groups and access to jobs and institutions for the so-called scheduled castes, success remains low. In contrast, violent conflicts between different religious and social groups appear again and again. This aggravates the development of a common economic orientation.

In China, a more homogenous society and the hierarchical political system help introducing common national targets. This does, however, not necessarily represent the public opinion. Continuing governmental interference in social concerns as well as lacking autonomy of economic factors depletes the accumulation of social capital and the formation of social networks.

In contrast to pluralistic structures of society in India this is, however, a problem the Communist Party can deal with and may solve in granting greater freedom to its people. Therefore, socioeconomic structures in China have the potential to develop more positively than in India, constituting a competitive advantage in the long run.

Closing, one fact is especially apparent. Positive values and norms in the sense that they are conducive to economic progress are more likely the higher, the educational level. Thus, access to education and knowledge will be the most crucial issue in economic politics in the future.

It is evidently clear from the above discussion that China has proved that its success.

depend upon its investment in health and education, gender equality and equal and equitable distribution of wealth even through non democratic influences. On the other hand India's low literacy rates and poor health outcomes as compared to China's may explain a big part of the disparity in development between the two countries. The fact that in India, people friendly and higher quality education and health policy could make difference, not only to people's lives but also on economic growth of the country. For India to match China it needs a better-educated and healthier labour force at all levels of society.

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