LAKSHMAN KADIRGAMAR INSTITUTE
OF INTERNATIONAL RELATIONS AND STRATEGIC STUDIES

TAKEAWAYS

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A Recovering Global Economy? The Dynamics of China and India in the Future of Global Growth

An LKI Roundtable with Dr. Ganeshan Wignaraja, LKI, Chair of the Global Economy Programme

Panelists: Hon. (Dr.) Harsha de Silva, Deputy Minister, Policy Planning and Economic Development;
Dr. Sarala Fernando, former Ambassador of Sri Lanka; and
Mr. James Crabtree, Visiting Senior Research Fellow, National University of Singapore and Contributing Editor, Financial Times

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Reported by Pabasara Kannangara and Kimberley Watson

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***Pabasara Kannangara** and **Kimberley Watson** are Research and Communications Assistants at the Lakshman Kadirgamar Institute of International Relations and Strategic Studies (LKI) in Colombo. These *Takeways* summarise the insights and discussion at a recent LKI event. They are not the views of the reporting author or the institutional views of LKI, and are not a complete report of the event.

Three key takeaways from Dr. Ganeshan Wignaraja's inaugural lecture -

1. **Amid policy uncertainty, the International Monetary Fund (IMF) predicts a recovering global economy in 2018. Therefore, it is important to explore China and India's respective economic strategies, since both countries are increasingly dominating global growth and trade.**
2. **Both countries have adopted various reforms and used foreign investment in a very strategic sense. However, their economies remain quite closed. While maintaining very careful control over liberalisation, China and India are growing incredibly fast and dominating the world economy.**
3. **If the right kind of economic policies are implemented, China is predicted to slow with a soft landing and India is projected to grow faster. However, there remains many risks remain both, globally and nationally. For example, in the long-term, China has to prepare for an aging population while India has to focus on connecting its urban and rural sectors.**

Introduction

- Dr. Ganeshan Wignaraja, LKI's Chair of the Global Economy Programme, delivered a lecture at the Lakshman Kadirgamar Institute on 31 October 2017 on "Recovering Global Economy? The Dynamics of China and India in the Future of Global Growth."
- The lecture was followed by a panel discussion, which was moderated by Dr. Indrajit Coomaraswamy, Governor of the Central Bank of Sri Lanka.
- Panelists included Hon. Dr. Harsha de Silva, Deputy Minister of Policy Planning and Economic Development, Dr. Sarala Fernando, former Ambassador of Sri Lanka, and Mr. James Crabtree, Visiting Senior Research Fellow at the National University of Singapore and Contributing Editor to the Financial Times.
- Over 170 people attended the lecture and discussion. The audience included officials of the Ministry of Foreign Affairs and other government institutions, the Sri Lankan military, Ambassadors and High Commissioners, other members of the diplomatic community, private sector leaders and representatives, officials of international organisations, representatives of think tanks, academics, students, the media and the general public.

Takeaways from Dr. Wignaraja's Lecture:

<u>Introduction</u>

- The IMF predicts a global economic recovery in 2018. The world is estimated to reach a growth rate of 3.7%. India is predicted to grow at 7.4%, whereas China is slowing to a rate of 6.5%. However, experts affirm that global growth will be increasingly driven by these two developing nations.

- Over the last 50 years, China's share of global GDP has grown from 2.3% to a staggering 19.2%. India, on the other hand, was only able to double its share from 2.9% to 8.0%. Nevertheless, states made significant advances in terms of poverty reduction, taking almost 800 million people out of poverty (measured at a USD 1.90 poverty line) over 20 years.

A Comparison of China and India's Economic Growth

- China's economy grew at an unprecedented rate of 10% per year for three decades, which has not been matched by any other economy in history. India grew at around 6% per year, which is also fairly rapid.
- The IMF states that the world economy is recovering after the 2008 financial crisis. However, global economic growth appears to be tepid at 3.7% growth per year. China's growth is slowing to 6% compared to previous growth rates of 10%, while India's growth is predicted to accelerate. Therefore, we should expect a change in the dynamic between the two powers. Big shifts in the global economy are taking place, as the US and Japan's shares of global GDP falls.
- Both giants followed a trade-led growth strategy; by the mid-2000s, China was able to overtake the US as the world's largest trader. Debates on protectionism and non-tariff barriers have stemmed from this scenario.
- As of 2015, China accounts for 13.1% of global merchandise exports, whereas India only makes up 1.7%. This is partly because China's trade has become sophisticated (geographically-distributed trade); it has become the global factory through labour productivity and unmatched economies of scale.
- China is leading in services exports. However, India dominates information, communication and technology services.

Economic Reforms in China and India

- From 1978 onwards, China pursued gradual and coordinated economic reforms that served as a catalyst for subsequent decades of growth. The reform programme, 'Market Socialism with Chinese Characteristics,' by Deng Xiaoping, emphasised a strong role for the state alongside controlled opening of market forces.
- By comparison, India's economic liberalisation did not begin until 1991 – more than a decade later – and focused more narrowly on easing foreign direct investment and import restrictions. India also increased the investment limit of Small and Medium Enterprises (SMEs) and permitted free determination of interest rates by banks.
- Today, firms in China enjoy a more competitive business environment than their counterparts in India, with more market-friendly rules for business start-ups regarding property registration, contract enforcement and bankruptcy. Global indexes acknowledge these differences, with China ranked 78 while India ranked 130 on the World Bank's Ease of Doing Business Index 2017.
- Each state has a strong leader with an ambitious economic vision. Xi Jinping became the Chinese President in 2012 and implemented 'change maker' policies. These

included: ending the One Child Policy to counter an aging population, launching an anti-corruption drive to root out corrupt officials and making the Renminbi (RMB) a world reserve currency (as a step towards the RMB becoming a global currency).

- Meanwhile, Indian Prime Minister Narendra Modi assumed office in 2014 and has pursued a radical reform agenda over the last 3 years. He has implemented a flurry of measures including (1) a nationwide sales tax, (2) the 'Make in India' initiative, (3) demonetisation of large currency notes, (4) fiscal reform, (5) investment climate reform, and (6) new social security programmes.

Outlook for China and India

- Growth in both countries will be driven not only by exports but also by heightened domestic as well as Asian demand. Services – fuelled by growing middle-class consumption – will play an increasingly important part in China and India's economic activity. India's reforms have made great strides and have begun to catch up with China; India's youth dividend is likely to drive this catch up.
- It also seems that China and India will switch places in terms of short-term future growth.
- However, many risks lie ahead which could negatively impact the two states' short-term growth outlook. These include political uncertainty, protectionism (including President Trump's 'America First' economic nationalism), tighter global financial conditions and weak productivity growth.
- Among the many challenges, social inclusion is a big problem in India and an aging population remains an obstacle for China. However, these countries are likely to continue to expand if they build on reforms while addressing these problems.

Key Points from the Discussion:

The Changing Geopolitical Landscape

- The rise of India and China was inevitable and has been accelerated by Brexit and the appointment of President Trump. Additionally, there are four major powers in Eurasia (Narendra Modi, Xi Jinping Vladimir Putin, and Shinzō Abe) aiming to influence the global order. In this context Sri Lanka needs to address and prepare for future political changes.
- The trajectory of India and China's respective geopolitical relations is clear: China is becoming more distant from India and the US, while India's relationship with Japan and the US is strengthening.
- Sri Lanka could become a 'realist' in its observations of China and India, and make its contributions to international relations by promoting a rules-based order to ensure some level of predictability.
- In his second term, President Xi Jinping may attempt to restructure the existing order in Asia to reflect China's interests. Therefore, many Asian countries may change their approach to international relations as a result of China's rise.

    - Countries like Laos and Cambodia are drawing on China's growth and aligning themselves with China's regional ambitions.
    - Others are forming alternative regional partnerships, exemplified in developing India-US relations and the return of the Indo-Pacific Quadrilateral Security Dialogue.
- Arguably, the current model of globalisation might be increasingly questioned in Sri Lanka.
    - Some of this unease is evident in public demonstrations over the South Asian Institute of Technology and Medicine (SAITM).
- However, rather than decelerating, globalisation will evolve from financial integration and trade deals to mega-regional connectivity initiatives like the China's Belt and Road Initiative and the smaller Asia-Africa growth corridor, led by India and Japan.

<u>Opportunities and Challenges</u>

- The rise of China and India is a challenge as well as an opportunity. Sri Lanka must ensure that it balances the interests of both giants while prioritising its own objectives of creating a highly competitive social market economy at the centre of the Indian Ocean and improving its standard of living.
- Over 700 million people are expected to join China and India's middle class by 2030, and Sri Lanka should maximise this opportunity to increase its exports in goods and services and attract Foreign Direct Investment (FDI).
- Various economic advantages could be secured if partnership agreements on preferential market access are finalised with China and India. These advantages include boosts to trade, tourism, investment, training and technology.
- As infrastructure (including ports, airports and roads) in both Sri Lanka and India significantly improve, business between the two countries can be conducted more effectively.
- Sri Lanka has an opportunity to benefit from its proximity to India, particularly with the economically dynamic southern Indian states (Andhra Pradesh, Karnataka, Kerala, Tamil Nadu and Telangana).
- Policy changes by the Modi government offer opportunities to advance Sri Lanka's interests.
    - Modi's 'Neighbourhood First' policy assures smaller neighbouring states of India's commitment to supporting regional stability.
    - Sri Lanka could also take advantage of the potential success of the 'Make in India' strategy by joining the supply chains of India's manufacturing sector.
- Sri Lanka's relationship with China, in particular, could benefit the country.
    - Sri Lanka's location in the middle of the maritime silk road is a significant advantage, with China shifting billions of dollars via this route.
    - However, Sri Lanka must ensure that China uses the ports in a manner agreeable to the global community and that Sri Lankan allies can still access the ports for commercial purposes.

- There are many countries that are close to trade routes. Therefore, a strong approach to good governance is a more effective route to prosperity for Sri Lanka than merely focusing on location.
- Sri Lanka needs a flexible economy to respond to supply chain disruptions such as artificial intelligence. This could be achieved via supply-side reforms (related to, for instance, education and connectivity).

Suggested Readings:

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