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Economic Reforms in China and India: Selected Issues in Industrial Policy

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Abstract

In this paper we compare the reform experiences of China and India focusing on three specific areas of industrial policy. We begin with a comparison of the macro economic performance of the two countries and find that except on the inflation front China is better placed than India. China has grown at almost double the rate of India largely because of very high savings and investment rates. Of course, economic reforms have provided the necessary policy environment for China to attain and sustain high growth.

First we compare the extent of deregulation in China and India in the areas of prices, labor and land laws, and exit policy for firms. We find that the non-state sector of China, which is the main driving force of China's impressive growth has performed so well largely because it operates primarily under market conditions. China has gone far ahead of India in respect of deregulation of their non-state sector. Price reforms have been extensive, labor is mobile, labor laws are liberal, and firms are free to enter and exit from the market. The results achieved in the process speak for themselves. In India, by contrast, much needs to be done for private sector deregulation, price reform has been limited, labor and land laws are stringent, and while firms have no entry barriers, they do, however, face strong exit barriers. *Second*, we draw comparison between the Chinese township and village enterprises and the Indian small scale industries. While these have been promoted in both the countries through preferential policies, however, their objectives have been different, and hence the results. Chinese small enterprises are given initial support only as against the policy in India wherein incentives are available as long as a firm remains in small scale. Moreover, in India, items are reserved to be produced exclusively by the small scale industry. While both have grown overtime, the ones in China have grown much faster. *Finally*, we compare special economic zones of China with export processing zones of India. We find that although both the countries have offered similar incentives to prospective investors, the story is very different in the two countries. The zones in China have been highly successful in attracting foreign investment, promoting exports, and generating employment than they have been in India. We identify a number of factors for the performance differentials in the two countries.

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Economic Reforms in China and India: Selected Issues in Industrial Policy

I. Introduction

China and India have differed markedly in growth performance over the past seventeen years. There are several reasons to explain such diverging trends, the most obvious being the success of China's economic reforms. Compared with India, China has been able to attain and maintain very high savings and investment rates. Furthermore, China initiated the process of economic reforms as early as 1978, while India did not commence its reform push until 1991. In addition, initial conditions in China were much more conducive for higher growth. In fact, because India's reforms were crisis-induced, the initial conditions in the two countries were quite dissimilar.

In this paper, we undertake an in-depth analysis of the policies that have affected macroeconomic performance in both countries and attempt to establish their linkages with growth performances. We identify and analyze the reasons for the impressive growth of China's non-state sector and explain, giving examples, how the deregulation measures have been instrumental in China's success. In order to illustrate the point, we take the example of Chinese township and village enterprises (TVEs) and the special economic zones (SEZs). For comparative purposes, we study small scale industry (SSI) and the export processing zones (EPZs), respectively, in India. We draw lessons for the SSIs and EPZs in India from the experiences of the TVEs and SEZs in China.

This paper is organized as follows: Section II discusses the macroeconomic performance of China and India. Section III analyzes certain aspects of deregulation, such as prices, labor and land laws, labor mobility, and entry/exit policies. Section IV studies the role of Chinese township and village enterprises in enhancing China's growth, and draws relevant lessons for the Indian small scale industry. In Section V we study policies relating to special economic zones in China and export processing zones in India, and analyze their impact on capital inflows and export performance. Finally in Section VI we present concluding remarks.

II. Macroeconomic performance

Both China and India belong to the group of low-income economies. Although China's GNP per capita in 1980 was \$290 and India's was \$240, the gap, however, widened considerably to \$490 and \$300, respectively, in 1993¹. Since the 1980s, China's growth rates have been about twice that of India, thanks to the economic reforms in China. Apart from significant changes in China's economic policies that contributed to high growth, there are, however, several other important differences in the macroeconomies of the two countries which may explain the differing performances.

¹ World Development Report, 1995, p 162. While the levels of per capita GNP data for both countries may be questionable, our intention is to compare the trend.

Table 1: Macro Indicators

	China^{#1}	India
GDP growth 1980-93	9.97%	5.26%
Population growth 1980-93	1.4%	2.0%
Fertility rate 1992	2.0%	6.1%
Adult illiteracy 1990	27%	52%
Total population (million)		
1981	1001	683
1994	1199	914
Employment ^{#2} (organized sector, million)		
1978	95.0	22.9
1994	148.5	27.4
Savings/GDP Ratio		
1978	38.2%	23.1%
1985	35.6%	19.8%
1993	41.5%	20.2%
Investment/GDP Ratio		
1978	38.0%	23.3%
1985	37.8%	22.2%
1993	43.5%	20.4%
Inflation Rate ^{#3}		
1978	0.7%	n.a.
1985	8.8%	6.7%
1993	13.2%	5.6%
1995	14.8%	5.0%
Openness Ratio		
1978	9.8%	n.a.
1980	12.6%	19.5%
1993	32.7%	27.1%
Debt Ratio 1993	95%	291%
Debt Service Ratio 1993	10%	28%

Source: Calculated by the authors based on data from: CSSB 1992, p 77; CSSB 1995, p 32, 36, 59, 88, 233, 537; Almanac of China's Foreign Economic Relations and Trade 1994/95, p 989; People's Daily, March 7, 1996, p 2; World Debt Tables 1994/95, p 218; Economic Survey, Government of India, 1994/1995; Reserve Bank of India; Human Development Report 1995, p 88 & 187. World Development Report 1995, p 162.

Note: #1 Since CSSB 1995 reestimated China's GDP, the above data could differ if one uses previous versions of CSSB.

#2 Organized sector employment data for China refers to total staff and workers. #3 Refers to retail price index for China, and consumer price index for India.

The higher growth rates of domestic savings and investment in China were, to a large extent, instrumental in achieving the high rates of growth. While the savings rates in India have been between 20 and 23 percent of GDP in the last two decades or so, the ratios for China have been about one-and-a-half to two times those of India. By roughly the same proportion, investment rates in

China have been higher than those in India². (Refer to table 1) In other words, both countries basically have been financing their investment through domestic savings. The difference in saving rates thus resulted, to a large extent, in the differential rates of economic growth.

Explaining the high rate of savings in China has always been a puzzle. Although the existing literature tends to credit this to Chinese culture, here we offer an alternative explanation. While a detailed explanation of why China achieved such high saving rates is beyond the scope of this paper, we point out some of the most important factors that have contributed to such a savings rate. These include: a) Change in population growth rates: China had a population growth rate of 2.1 percent between 1950 and 1973, with the rate falling to 1.4 percent between 1973 and 1994³. b) The abrupt change in population growth rates in China implied a change in the population structure, which is indeed what has happened. The share of the working-age population increased from 59.3 percent⁴ in 1953 to 66.7 percent in 1994⁵. c) High economic growth in China enabled the creation of many new substantial jobs, and as a result, the rate of dependency per worker was reduced. Briefly put, these factors have contributed significantly towards higher saving rates in China.

Employment is another major macro indicator used to evaluate the health of an economy. While employment in the organized sector in China, including staff and workers, increased from 95 million in 1978 to 148.5 million in 1994, a rise of 56 percent, the number for India, in contrast, rose by only 19.7 percent - from 22.9 million to 27.4 million. Moreover, between 1981 and 1994, India's population increased by 33.82 percent while China's population increased by 19.8 percent. In the case of China, the unemployment rate has always been kept reasonably low. In 1952, when the People's Republic of China was only two years old, the urban unemployment rate was 13.2 percent⁶. The Chinese government addressed the unemployment issue as a primary issue head on and incorporated it into the first five-year plan economic development; by 1957 the rate had come down to 5.9 percent. Since the onset of economic reforms, China's urban unemployment rate has come down to 2.9 percent in 1995⁷ from 5.3 percent in 1978. The low unemployment rate for China at the start of the reform facilitated reform, and a sustained low unemployment rate provides a healthy economic environment for China's reforms in the years to come. With respect to India, unemployment data is available only for the organized sector. However, the National Sample Survey Organization (NSSO) provides survey data for both the organized and unorganized sectors on a five-year basis. Per the usual approach, which focuses attention on chronic unemployment, the urban

² In 1993, foreign direct investment in China accounted for 10.6% to 15.9% of total domestic investment, using the official exchange rate (\$1=Yuan 5.80) and swap market rate (\$1=Yuan 8.70).

³ The substantial decline in China's population growth rate between 1973-94 is largely responsible for China's high savings rate.

⁴ Zhou & Dang, China's Population Situation, 1990, p 194.

⁵ Calculation based on data from China Population Statistics Yearbook 1995, p 6-10.

⁶ CSSB 1994, p 106 for urban unemployment rate data.

⁷ CSSB, People's Daily, March 7, 1996, p 5.

unemployment rate stayed roughly constant at 5 to 6 percent for the 1970s and 1980s. However, the rural unemployment rate went up slightly, from less than 1 percent to about 2 percent over the same period. Although unemployment for India as a whole also stayed relatively constant in this period the composition of the work units in which the educated workforce is employed has changed. The proportion of educated people opting for self-employment has risen considerably between 1977-78 and 1987-88⁸. This is true for both males and females in rural and urban areas, thereby indicating that India's employment growth has mainly come from the private sector.

Openness has been increasingly recognized as an important factor for attaining higher growth. Therefore, reform strategies have, in almost in all countries, included measures for opening up economies. China and India have been no exception. In China, openness as measured by the ratio of total trade of goods and service over GDP, rose from 9.8 percent in 1978 to 33 percent in 1993. While 4.6 percent of China's GDP originated from exports in 1978, the ratio rose to 15.3 percent in 1993. With a 19.5 percent openness ratio India was much more open than China in 1980. However, even though India's external trade as a percent of GDP increased over time, in 1993 her openness was only 27.1 percent.

Debt ratio (total external debt/export earnings) and debt service ratio are two important indicators often used to determine a country's health with regard to its external economy. With the huge increase in China's external debt, her debt ratio has been increasing since reform. However, both the debt ratio and debt service ratio have been within the safe limits recognized by international standards (100 percent for debt ratio and 20 percent for debt service ratio). To a large extent, this has been possible because exports have grown so rapidly. In contrast, despite the fact that India's debt profile has been much more favorable (with 47 percent of the total debt on concessional terms), both the ratios exceeded the safe limits, at 291 percent for debt ratio and 28 percent for debt service ratio in 1993.

On the downside, higher growth rates in China have been associated with higher inflation. China started its reforms with basically no inflation, but it has risen over time and been aggravated in the recent past. To a large extent, this trend has emerged due to: the removal of price controls; hikes in administered prices, especially for agricultural products; reforms in the distribution system; fiscal decentralization; a sharp rise in the demand for fixed asset investments; and excessive inflows of foreign capital. In the Indian case, high inflation has existed at times for varying reasons. In the 1980s, large and growing fiscal deficits were a major cause of inflation. The gross fiscal deficit (center and states) as a percent of GDP rose from 9 percent in 1980-81 to 12.7 percent in 1990-91. These deficits led to high levels of borrowing by the government from the Central Bank, with an expansionary impact on the money supply that led directly to high rates of inflation. However, over the last couple of years, inflation has risen particularly because of price reforms, periodic increases in the administered prices of food grains, worsening of the fiscal situation due to higher subsidies and interest payments in 1993-94, and large inflows of foreign capital.

⁸ For detailed data, refer to Visaria and Minhas, 1991, p 975.

III. Deregulation: Price Control, Labor Mobility and Entry/Exit Policies

Prior to the economic reforms, China's economy was rather rigid because of the planned economic system. Under such a planned system, control was the key to keeping stability, and almost every activity one could think of was regulated. The main theme of the reform is to move away from planning and to deregulate the economy, which is often referred to as the decentralization of decision making power. In this section, we look at some deregulation measures in the areas of prices, labor mobility, and entry and exit policies.

Price Policy in China

Before 1979, prices were centrally controlled and prices were set by the government. Enterprises did not have much of a say and there was very little price variation across regions. For many products, prices were fixed for decades with the result that price distortion was a serious problem, especially in the early years of reform. To reform the price system, China took the following steps: a) increased agricultural procurement prices in coordination with rural reforms; b) readjusted price structures in line with production costs, and adjusted price levels across sectors, such as prices for agricultural products and tools, for light and heavy industrial goods, and for transportation and communication; c) introduced a dual-track price system such that prices were gradually determined by the market. The SOEs gradually increased the share of prices set by the market while letting the non-state sector have more freedom in price decisions.

After 17 years of reforms, prices are now basically determined by the market. According to Vice Premier Li Lanqin, prices that are determined by market forces are 80 percent for capital goods, 85 percent for agricultural goods, and 95 percent for manufactured consumer goods⁹. In contrast, in 1978, 97 percent of retail prices and 100 percent of prices for material inputs were determined by the government¹⁰.

Labor Mobility in China

Deregulation of labor mobility, especially rural migration, has also contributed significantly to China's economic growth. Before the reforms, much labor was wasted and was kept under capacity for many reasons under the planned economy. The main reason, perhaps, was the segregation of rural and urban residents through the household registry system. Under this system, every household was required to register its place of residence, and was required to seek permission to change residences. Prior to the early 1980s, migration was extremely difficult. For example, farmers found it very difficult to survive in cities because they were denied access to rationed food and urban social welfare. Even urban workers found it difficult to move within a city due to housing and other considerations. Hence, under the registry system there was very limited labor mobility.

⁹ Li Lanqin, Beijing Review, vol. 39, No. 2., Jan. 8-12, 1996.

¹⁰ Gao, Wang, & He, 1994, p 194. And Xu & Wang, 1994, P 390 also says that the government set the prices for 97% of the total volume of retail commodity sales.

Labor mobility has been deregulated in two ways since 1979. First, by granting the rural population a choice of economic activities that differs from traditional agriculture, the government allowed rural residents set up businesses and work in factories or firms, regardless of their location, especially after 1984. As a result, the surplus rural labor shifted from the agricultural sector to other sectors. About 95 million joined the TVEs between 1979 and 1994. An estimated 80 million of the rural population migrated into urban area, most of which are along the coastal regions. Secondly, workers were allowed to resign or retire at an early age, and firms were given the freedom to hire and set wages. In addition, two other factors also facilitated labor mobility. First, many provinces and cities, especially the SEZs and ETDZs, adopted favorable policies to attract professionals and graduates, thereby providing immediate housing and favorable benefit packages. Second, to facilitate the flow of human capital, many city governments set up human capital exchange centers to provide demand and supply information.

Entry/Exit Policies in China

China has made attempts to promote competition through various means. First, to promote entry, tax holidays and tax reductions are granted to newly established TVEs, and firms with foreign investments (as we discussed in Sections III & IV). Second, demonopolizing state industries has helped greatly - e.g., Bank of China used to be the only bank allowed to deal with foreign exchange business. Subsequently, China International Trust and Investment Corporation was allowed to conduct foreign operations, as were all the specialized banks. Later on, a number of other financial institutions also joined in. In 1995, the first domestic private bank, Minsheng Bank, was established in China. Thirdly, the Corporation Law was promulgated in 1995. Under this law, firms are allowed to merge, switch production lines, and close down, if necessary. Such flexible entry and exit policies, along with other macro policies, have promoted competition and efficiency in the Chinese economy, especially along the coastal regions.

Price Policy in India

In India, the government fixes prices of certain agricultural commodities and industrial products. The agricultural price policy seeks to develop a balanced and integrated price structure from the perspective of the overall needs of the economy. In addition, the policy is supposed to ensure remunerative prices to the growers and to safeguard the interests of the consumer by making available supplies at reasonable prices. Each season the government announces procurement/support prices for major agricultural commodities and organizes purchase operations through public and co-operative agencies, such as the Food Corporation of India (FCI). The commodities covered for the fixation of procurement/minimum support prices include seven cereals (paddy, wheat, jowar, bajra, maize, ragi, and barley), four pulses (gram, arhar, moong, and urad), seven oilseeds (groundnut, sunflower, soyabean, rapeseed and mustard, safflower, toria, and copra), and four other commodities (sugarcane, cotton, jute, and tobacco). The prices of these agricultural commodities are fixed by the government upon the recommendations of the Commission for Agricultural Costs and Prices (CACP).

Through a Public Distribution System (PDS), the government supplies six key-essential commodities at below market rates to consumers, with access to the system being universal. In India, the PDS has been in existence since World War II. Food grains -- mainly rice and wheat,

sugar, edible oils, kerosene, and soft-coke -- are distributed to the public through a network of fair price shops (FPS). The PDS aims at insulating the consumer from the impacts of rising prices of these commodities and maintaining the minimum nutritional status of the population. Typically, each FPS is required to serve a population of 2,000. As of the end of March, 1994, there were 424,000 fair price shops, of which 324,000 were located in rural areas and 100,000 in urban areas. Although the central government procures, allocates, and supplies these commodities to the states or the union territories, the latter, in turn, are responsible for the allocation and distribution within their respective areas.

Table 2: Food grain Allocation and Off-take under PDS (million tons)

Year	Wheat		Rice	
	Allocation	Off-take	Allocation	Off-take
1990-91	9.50	7.09	9.61	7.87
1991-92	10.36	8.78	11.36	9.94
1992-93	9.24	7.41	11.48	9.36
1993-94	9.56	5.86	12.41	8.88
1993-94(Apr-Dec)	7.01	4.03	9.03	6.77
1994-95(Apr-Dec)	7.91	3.20	9.90	5.86

Source: Economic Survey, 1994-95, Government of India.

As shown in table 2, the PDS Off-take (amount sold by the FPS) has been declining over the last three years. To a large extent, this is explained by the reduced use of PDS by consumers, particularly in the urban areas. Studies have shown that consumers perceive grain from open market outlets to be of higher quality than the grain available at the FPS. This is one of the main reasons for the declining off-take from the FPS. It is particularly so in the case of wheat in the wheat-consuming states. An overhauling of the public distribution system needs to be done, and at a minimum, it needs to be restricted to rural consumers only. Although a number of criteria have been suggested for improved targeting of the poor and the most vulnerable elements in society, the government has yet to initiate action on this front.

By targeting consumers who have access to the system, better quality food grains could be made available. This could also help reduce food subsidies. In 1994-95, the food subsidy budget was Rs. 400 million; however, the actual amount may turn out to be much higher due to the large volume of procurement, the higher carrying costs, and the lower off-take from PDS. In fact, the same happened in the previous year, too. Subsidies arise from the difference between the issue price and the operation costs of the FCI. For some time now the issue of limiting open-ended subsidies on account of FCI operations has been discussed in government. However, again no concrete action has been taken so far.

With regard to industrial products, prices prior to 1991-92 were fixed for seven commodity groups. These were: crude petroleum and natural gas, petroleum products, coal, electricity, fertilizers, iron and steel, and non-ferrous metals, (excluding aluminum). However, since the decontrol/decanalization of steel, non-ferrous metals, and fertilizers (except urea), the major items

under administered price control are coal, electricity, and petroleum products (though lubricating oil was decontrolled in November 1993).

Exit Policy, including labor and land laws

Removal of exit barriers is one area in which the Indian reforms have yet to commence. The exit policy is a set of policies or measures concerning industrial decline, retrenchment, restructuring of ailing firms, and liquidation of closed units. Although the government took swift action in removing the entry barriers that were present for decades in such forms as licensing and exclusion of domestic and foreign investors from many industries, the liberalization of exit barriers has yet to take place. In 1993, the government formed the Committee on Industrial Sickness and Corporate Restructuring (CISCR) to reexamine the regulatory framework of restructuring and liquidation of corporate firms. However, no concrete action has so far been taken on the recommendations of the committee's report.

A large number of firms in the private and public sector continue to incur losses, yet stay in operation through public subsidies, or remain in a state of suspended animation (the state of sick industrial units) by closing down indefinitely without seeking formal liquidation. In the process, workers of closed units lose their jobs without any compensation, and the owner of the unit may also lose his locked-in capital. Creditors, mainly public sector banks, always end up losing their money. According to the Sick Industrial Companies (special provisions) Act of 1985 (SICA), a unit will be called sick if the unit is registered for five years and has accumulated losses in excess of its net worth.

By March 1991, there were approximately 2,269 large and medium size units in the private sector which were listed as sick -- with a total bad debt of Rs. 57.86 billion. In the public sector, on the other hand, there were 109 loss-making enterprises which incurred a total (annual) loss of Rs. 30.64 billion (Tables 3 and 4). In addition, in the public sector, the net profit/loss to capital employed ratio is very small.

Table 3: Number of Sick Units and Amount of Outstanding Credit per Unit (Private Sector)

	Unit	1980	1986	1990
Small scale	000'	23,149	145,776	225,324
credit outstanding	Rs. Mn	0.13	0.08	0.11
Medium scale	000'	992	1,250	802 [#]
credit outstanding	Rs. Mn	1.8	2.25	NA
Large scale	000'	409	714	1,467
credit outstanding	Rs. Mn	32.3	46.0	32.2

[#] Sick public sector units may also be included in this figure as they are obtained from cross calculations.

Source: Summary Statistics, Center for Monitoring Indian Economy, 1992.

Table 4: Number of Loss-making Enterprises and Total Amount of Losses Incurred (Public Sector)

	Unit	1980	1986	1990
Number of operating enterprises	No.	168	214	236
Number of Loss-making enterprises	No.	74	100	109
Total capital employed	Rs. Bn	182	518	1,017
Losses of Loss-making enterprises	Rs. Bn	7.6	17.0	30.6
% of Net Profit/Loss to capital employed	Percent	1.1	3.4	2.3

Source: Eighth Five-Year Plan, 1992-97, Vol. II, Planning Commission, Government of India, p. 123.

Failure to restructure in time results in the firms going bankrupt. A number of factors such as hostile unions, legal and regulatory obligations, etc. are responsible for firms not restructuring in time to avoid bankruptcy. Strong union practices (protected under the Trade Union Act of 1926 in all registered firms) have systematically opposed restructuring to various degrees.

Second, the regulatory framework is such that if a unit has fallen sick, then the unit does not have the option to restructure on its own. SICA requires that the unit must be referred to the Board of Industrial and Financial Reconstruction (BIFR). BIFR is the sole regulatory agency for large and medium-size firms, and restructuring can be done only if the restructuring plan is approved by BIFR. The consensus approach adopted by BIFR is a major source of the exit problem. At every level of mediation and decision making, BIFR uses the consensus approach. A restructuring plan suggested by one party needs to be endorsed by all the parties concerned, that is, the management, workers, creditors, and shareholders.

Third, legislative barriers have also helped to prevent not allowing firms from restructuring easily. Several pieces of legislation concerning labor and land, which have been in effect since the mid-1970s, severely restrict the scope of firm restructuring, not to mention the restrictions on the importation of new technologies and the licensing and regulation of capital which were present in the pre-1991 period. Nonetheless, legal provisions for job security and the land-use law have posed serious obstacles to the process of restructuring. According to the Industrial Disputes Act of 1947, firms in India employing 100 or more workers are not allowed to retrench or layoff any workers, or close down a unit without prior permission from the concerned state government. State governments have almost never given explicit permission to firms to retrench or close down a unit. Effectively this law has become a guarantor of job security in privately owned large firms, very much in line with the job security provided to public sector employees.

With regard to the land-use law, the Urban Land (Ceiling and Regulation) Act of 1976 does not allow firms to sell surplus land in major cities without the permission of the state government. A large number of sick textile mills in Bombay and Ahmedabad and jute mills around Calcutta are in possession of surplus land, that could be sold to raise funds for restructuring. However, the state governments have systematically denied permission to sell them¹¹.

The Urban Land Ceiling Act specifies an upper limit on the size of landed property that an individual, a group of people, or a company can own. In the major metropolitan areas, like Bombay and Calcutta, the limit is 500 square meters. In minor cities like Ahmedabad it is 1,000 square meters. If a firm is in possession of surplus land, it must inform the state government of the amount of surplus land. The state government then buys the excess land at some pre-specified rate, which is significantly lower than the market rate.

Comparison

In the field of deregulation, especially in the areas of prices, labor mobility, and entry/exit policies for firms, China has gone far beyond India, and the results achieved via deregulation measures in China speak for themselves. While pre-reform China was much more regulated and controlled than pre-reform India, China today has done away with most of those regulations that would normally hinder the growth of industry. Price reforms have come a long way in China, and have been a major reason for the boom in the agricultural sector. In India, on the other hand, the procurement/support prices have been raised over time, but are still state-determined. Besides, as discussed earlier, India also has a public distribution system through which commodities are made available at subsidized prices. Such a system, though widespread extensively in pre-reform China, is now much reduced. PDS in India needs major overhauling, with improved targeting of the poor and the vulnerable sectors of society. With regard to industrial products, however, prices of several products have been decontrolled in India over the past five years.

While there have been no restrictions on labor mobility in India, in China it was a major impediment for attaining higher growth until the commencement of the reforms. The authorities in China realized the existence of this bottleneck early on in the reform process and hence undertook measures to relax the restrictions on labor mobility. As a consequence, the segmentation of the labor market in China (between urban and rural labor and agricultural and industrial labor) was removed, thereby implying that labor was free to move from one sector to the other, from rural to urban areas and so on. Mobility permitted surplus labor to move from agriculture to engage itself in small business, or take up employment in the fast-growing rural industry. The labor market soon began to be governed by market forces, thereby unleashing strong forces that promoted growth in the Chinese economy for years to come.

Firms in China are relatively free to enter and exit the market as their situations may warrant. The labor law enacted in 1995 states that both the employee and the employer have to give 30-day

¹¹. As an exceptional case, according to an order of the Maharashtra government issued in March 1996, the National Textile Corporation (NTC) mills have been granted permission to sell their excess land. The land is being sold to raise funds for the revival of the chronically sick mills and for their modernization.

notice to the other party in the event that their labor contract has to be discontinued. In case the firm needs to use layoffs due to production difficulties or is on the edge of bankruptcy, the employer has to make it known, both to employees and the labor union 30 days in advance, and must report it to the government administrative authority. By contrast, in India, while entry barriers have been lifted, there still exist strong exit barriers. Moreover, even the restructuring of firms in India is severely constrained because of the stringent regulatory framework that is in place. Needless to say, liquidation of firms is out of the question. In India, large numbers of loss-making firms both in the private and public sectors are unable to restructure or exit. These firms stay in operation through public subsidies or “go sick” by indefinite closure without going for formal liquidation. Labor laws do not allow large firms to lay off workers. Besides, the land laws are such that firms cannot sell their excess land or acquire additional land beyond a certain limit prescribed by the government. Numerous factors such as hostile trade unions and legal and regulatory obligations do not permit firms to restructure or exit. As in China, India needs to have realistic labor and land laws that give firms the necessary flexibility to conduct their operations.

IV. Small scale industry: China's TVEs and India's small scale enterprises

Both China and India are poor in capital, but abundant in labor, especially unskilled labor. With such a resource pattern, development policies that promote labor-intensive industries (and exports) would hasten the process of economic development and industrialization, as experienced by the high performing East Asian economies. Small scale industries in LDCs are usually associated with low capital intensity and low-skilled labor. As such, promoting such industries would appear to be the proper economic policy for China and India. In this section, we attempt to compare the policies and development experiences of small scale industries and their effects on the two economies. In the case of China, township and village enterprises (TVEs) are considered instead of small-scale industries. Though TVEs cover more than industrial products, given their nature, size, and government policies, we think such a comparison will be meaningful and will help us understand the differences between the two countries' recent economic development experiences.

China's TVEs

While China's overall economic performance has been successful since the reforms were initiated in 1978, growth rates for the non-state sector have been extremely impressive. Within the non-state sector, the growth of TVEs has been the most spectacular. TVE share of social gross output¹² increased from 7.2 percent in 1978 to 42.7 percent in 1993. The TVE export share increased from basically zero to more than one-third in 1994¹³. TVEs have created about 95 million jobs since the reforms began. The share of TVE employment went up from 7 percent in 1978 to 20.5 percent in 1993 (Table 5). In this section, we propose to study why China's TVEs have grown so fast, and what conditions and policies provided such an environment for growth. Then we will study the

¹² Social gross output has a double-accounting problem, but GDP data are not available for the TVEs. Here we hope to give a sense of the change in national output, rather than in the levels.

¹³ Chen, Junsheng, Township Enterprises: Developing an Export-Oriented Economy, in Beijing Review, Vol. 39, No. 2, Jan 8-12, 1996.

Indian development experiences of small scale industry, and see what China and India can learn from each other.

Table 5: China's TVE Development

Years	1978 ^{#1}	1984	1991	1993
Employment (million)	28.27	52.08	96.09	123.45
Gross output (Billion yuan)	0.49	1.71	11.62	31.54
Units (million)	1.52	6.07	19.09	24.53
Share of National Employment	7.04%	10.8%	16.47%	20.50%
Share of National Gross output	7.20%	12.98%	26.33%	42.73%
Average Employment (person)	18.60	8.60	5.03	5.03

Source: CSSB 1994, p 84-85, p 362-3, CSSB, China Industrial Statistical Yearbook 1994, p 15.

Note: 1978 data do not include TVEs run by groups of households or by individuals. Therefore while other data are under-reported, average employment per unit is large relative to subsequent years due to the fact that they do not include the smaller TVEs run by groups of households or by individuals.

TVEs basically comprise all rural enterprises, including all forms of collective ownership, joint ventures, enterprises incorporated with state-owned enterprises, and private enterprises. Although they existed before the reforms, they were much smaller in number. In 1958, China undertook the Great Leap Forward, wherein the government required every rural cooperative, which later turned into the people's commune, to set up industrial enterprises. By 1960, there were 117,000 rural enterprises, which were producing 3.2 billion Yuan¹⁴ or 1.19 percent of the country's social gross output. During the Cultural Revolution, rural enterprises expanded further for a number of reasons: a) the government wanted to promote agricultural mechanization, and encouraged "five small scale industries" in rural areas to satisfy rural demand; b) many enterprises in cities were busy with political movements rather than production activities, so rural enterprises were set up to meet rural production purposes; c) large batches of educated youth were sent by the government to settle in the countryside, and their knowledge facilitated some of the industrial production. In 1978, the number of rural enterprises went up to 1.52 million, at which time they were producing 7.2 percent of the country's gross social output. However, the real growth of the TVEs took place after the reforms.

Rural reforms began with the replacement of the household responsibility system with the commune system. This met with tremendous success and provided a favorable economic environment for the growth of TVEs. The 1978 to 1984 annual compounded growth rate of grain production (in physical terms) doubled the rate between 1952 and 1978 (4.95 percent vs 2.41 percent). The increase in productivity provided peasants with extra income and resulted in additional surplus labor.

While increased rural savings and cheap local labor provided TVEs with the material basis for growth, the government established policies that created favorable macro-economic environment

¹⁴ Gao, Wang & He, 1993, p 1678.

for TVE development. In 1978, the Third Session of the Eleventh Plenary of the Communist Party of the China Central Committee (CPCCC) documented that (a) urban factories should support TVEs (then called commune- and brigade-run enterprises) with equipment and technical guidance so that some rural products and tools could be processed by TVEs; (b) TVEs were granted tax reductions or exemptions depending on their situations. The government encouraged TVE development especially in areas that supported or promoted agricultural production, heavy industry, and exports.

Since then, many governmental policies have been introduced to encourage the growth of TVEs. Among them, tax policies have played perhaps the most significant role in TVE development. Since 1979, newly established TVEs have been given between one- and three-year tax holiday, and taxes have been either waived or reduced for two to three years for unprofitable TVEs. In addition to preferential tax treatment, since 1984, TVEs have paid an eight-level marginal corporate tax (see Table 6), this rate applied until 1994, when all domestic enterprises started to pay a unified tax rate of 33 percent. Since TVEs on average are much smaller (only 5 persons on average, see Table 3), and each one makes a smaller profit than the bigger SOEs, this marginal tax scheme promoted TVEs at the expense of the SOEs. On top of that, large and medium size SOEs were subject to a flat 55 percent tax rate rather than marginal tax rates.

The Spark Plan is another major Chinese government initiative that contributed to TVE development. This Plan was initiated in January 1986 to promote rural science and technology development, and has in effect promoted TVE development. The Plan targeted the promotion of small- and medium-size rural enterprises with three main objectives: (a) Provide short-term training to 200,000 rural educated youth and cadres every year, with a goal of teaching them one or two techniques applicable in their areas; (b) Mobilize research institutions at the central and provincial levels to develop 100 full sets of technology equipment suitable for rural usage; (c) Help to establish 500 small TVEs as models for further development, providing them with technology, management knowledge, processing techniques, and quality control measures¹⁵. Over the last decade, The Spark Plan initiated about 60,000 projects, has made a total investment of 259.2 billion Yuan, and has trained more than 28 million peasants.¹⁶

The Chinese government also generated policies to promote the development of export-oriented TVEs in the coastal development regions. Although export oriented TVEs are charged the same interest rates on loans for technological improvement projects, they are allowed to pay reduced corporate tax during the loan repayment period. TVEs that produce export goods are rewarded with 0.05 Yuan for every dollar they export.

¹⁵ A Comprehensive Book of Chinese Reforms, Volume on Rural Reforms, p 29.

¹⁶ People's Daily (Overseas Edition), Jan. 24, 1996, p 1.

Table 6: China's Domestic Corporate Tax Rates (1985 - 1993)

Tax Level	Annual Taxable Income (Yuan)	Tax Rate
1	<= 1000	10%
2	1001--- 3,500	20%
3	3501--- 10,000	28%
4	10001--- 25,000	35%
5	25001--- 50,000	42%
6	50,001--- 100,000	48%
7	100,001--- 200,000	53%
8	> 200,000	55%

Source: The State Tax Bureau, A Comprehensive Book of Tax Laws, 1989, p 319, 342.

Note: For medium and large size SOEs the rate was 55% .

While the central government was setting general guidelines for promoting export-oriented TVEs, local governments have created various policies to encourage TVE development. For instance, to promote exports, the Beijing government now reduces corporate tax by half for TVEs that export 70 percent or more of their products if net earnings increases over the previous year. And TVEs are allowed to retain 40 to 50 percent of foreign exchange earnings under the retained foreign exchange earning system. To encourage high-quality TVE products, the Tianjin government allows a 5 to 20 percent corporate tax reduction for products that are recognized as high-quality by the municipal, ministerial, or national governments. The Shaanxi government has spent half of the money from the Spark Plan to promote advances in suitable technologies for the TVEs¹⁷. To promote inter-regional TVE development, the central government has mandated that TVEs should enjoy all preferential policies allowable in the locality in which they are operating, regardless of their original location.

Table 7: Loans Extended to TVEs

(a) Loans Extended during the Year	<u>1985</u>	<u>1988</u>	<u>1990</u>	<u>1992</u>
National Total (billion Yuan)	627	1143	1654	2404
TVEs ^{#1} (billion Yuan)	35	87	123	188
TVE Share of national loan (%)	5.6	7.61	7.44	7.82
(b) TVEs	<u>1979</u>	<u>1980</u>	<u>1990</u>	<u>1992</u>
Loan Balances, (year-end, billion Yuan)	4.4	8.1	116.3	187.8
Loan Balance/100 Yuan Product	8.9	12.0	12.1	10.7
Labor Productivity/Per Person (Yuan)	1751	2230	10342	16632
Profit before Taxes/Person (Yuan)	389	480	1092	1668

Source: (a) 1992, 1993 Almanac of China's Finance and Banking p 456 & 356. (b) China's TVEs Yearbook 1993, p 476.

Note: #1 includes non-profitable institutions in rural areas.

¹⁷ Fu, Chunseng, Zhang, Xuewen, & Ma, Qiangxin, 1993, p 66-73.

Nonetheless, in terms of sources of funds, TVEs basically stand on their own. TVEs are encouraged to raise funds within and among enterprises, and from individuals and communities. In the early years, TVEs were charged higher interest rates for their operating capital loans. In 1985, interest charged on operating capital loans to TVEs was 8.64 percent, compared with 7.92 percent for the SOEs¹⁸. However, although we do not know when it began, TVEs are now charged the same interest rates as other enterprises¹⁹. The share of loans that TVEs have received has increased from a negligible number in 1978 to about 5.6 percent in 1985, and increased more to 7.8 percent today, and loan volume has increased by a significant margin every year. (table 7)

Preferential tax policies towards TVEs seem to have been most instrumental in TVE development. Tax exemptions or reductions effectively made the average corporate tax rate for TVEs as low as 21 percent, while the SOEs, on average paid a 29 percent corporate tax rate in 1992²⁰. Cheap labor is definitely a big advantage for TVEs. In addition, compared with SOEs, TVEs incur very little in the way of social welfare costs. Most TVEs do not provide pensions, medical care, or housing. Unlike SOEs, TVEs basically have been free to set their prices, and to decide the amount of inputs and outputs. Aside from this, flexible management within the firm, and a supportive attitude from local governments are essential to the large-scale development of TVEs. All of these factors have put TVEs in a much better position to compete and develop. As Table 7 indicates, labor productivity of TVEs has increased tremendously from 389 Yuan per person in 1979 to 1668 Yuan per person in 1992²¹.

Small-scale industry in India

Small-scale industry (SSI) has played an important role in the industrial development of India. In 1994, this industrial segment employed 14 million workers and accounted for 40 percent of India's total manufacturing output and 35 percent of its exports²². During the last three decades, this sector has seen consistent growth in the areas of production, employment, and exports. In order to qualify as small-scale, an industrial unit has to satisfy the following criteria:

(a) The fixed investment in plant and machinery (original value), whether held on ownership terms or on lease, should not exceed Rs. 6 million;

¹⁸ The People's Bank of China, Survey and Statistics Department, *China Statistics on Finance and Banking (1952-87)*, 1988, p 145. The higher interest rate charged on TVEs, however, need not mean bias against them. The People's Bank of China (Central Bank), in 1987, made an announcement that specialized banks were allowed to float lending rate 20% above the base rates.

¹⁹ *Almanac of China's Finance and Banking*, 1994, p 499.

²⁰ Shi, Banruo. 1994: *China's Tax System Reform*, 1994, p 263.

²¹ Discounted by the overall retail price index, TVE labor productivity would be 755 Yuan per person at 1979's value.

²² Budget Speech of the Finance Minister - Presenting Central Government's Budget for 1995-96, [Part-A] p. 8

(b) If an industrial undertaking is above the limit of Rs. 6 million, then it can continue as an SSI as long as its fixed investment in plant and machinery does not exceed Rs. 7.5 million; moreover, it must export at least 30 percent of its annual production by the end of third year of production; and

(c) In the case of an ancillary unit, the fixed investment in plant and machinery cannot exceed Rs. 7.5 million.

Reservation Policy for the SSI

One of the most distinct industrial policies in India is the itemized reservation policy for SSI. Under this policy, certain items have been exclusively reserved for manufacturing in SSI sector. The objective is to protect the SSI units engaged in the manufacturing of such items from the competition of medium- and large-scale units. The reservation policy prevents the creation of new capacities in the large-scale sector in areas which are well within the competence of the SSI sector so that the small-scale units are able to cater to the additional demands of the reserved items. However, large-scale units with a minimum export obligation of 75 percent of their output are allowed to enter into the production of reserved items. The number of items on the reserved list have risen from 47 in 1967 to as high as 836 in 1995.

The institutional framework has aimed at nurturing the SSI by creating a conducive environment in which to operate. In addition, a strong incentive scheme has been put in place to provide the SSI with a competitive edge in the market. Although institutional support and incentive schemes have been found in a number of countries for promotion of small-scale industries, the policy of reservation seems to be unique to India, and non-existent in other parts of the developing world. Be that as it may, the small scale industries are not seen to be heavily engaged in the production of reserved items.

The question arises as to whether there is any rationale for continuing the policy of product reservation for the SSI. Particularly in the context of the reform program that India is currently undertaking, such a reservation policy is an aberration for the economy. Despite these reservations, the reserved SSI has not emerged as a predominant sector in the small-scale industry.

Incentive Schemes for Small-Scale Industries

A variety of incentives have been developed over the years to promote the SSI sector. The Small Scale Industrial Development Bank of India (SIDBI) provides direct assistance for specialized marketing agencies, industrial estates, acquisition of machinery/equipment (both indigenous and imported), equity capital through soft loan schemes (such as the seed-capital scheme and National Equity Fund Scheme), modernization schemes, bills rediscounting, and direct discounting schemes. In addition, state and local governments have provided financial subsidies to the SSI, including interest rate and capital subsidies, water and electricity subsidies, and subsidies for the acquisition of land.

In addition, the government provides a number of fiscal incentives to the SSI sector. These comprise investment allowances, tax holidays, additional depreciation for new plant and machinery,

and excise tax concessions by the central government (the small-scale excise exemption scheme allows for tax exemptions for SSI units). Under this scheme, SSI units having annual turnover up to rupees 3 million are exempted from payment of excise duties. If the turnover is between rupees 3 million and 7.5 million, then duties are concessional. The ceiling of turnover for availing the exemption/concessions from sales taxes and turnover taxes is rupees 20 million. With a view to develop the backward districts, the government has provided a five-year tax holiday to new industrial undertakings located in backward districts that are certified by the central government. In addition, the state and local governments provide exemption from electricity tariffs.

The SSI sector is also entitled to certain general incentives, such as reservation of certain items for exclusive purchase from SSIs, price preference over medium- and large-scale units in public sector purchases, and schemes for self-employment for educated, unemployed youth. Furthermore, if the SSI unit happens to be located in a backward area, then the unit has access to special incentives, such as concessional finance schemes, transport subsidy schemes, interest subsidy schemes, and income tax incentives.

Since the initiation of economic reforms in India, the government has undertaken a number of policy initiatives to achieve the objectives of the new Industrial Policy in the post-reform period. Several measures have been undertaken for the simplification of rules and procedures in order to achieve deregulation: disbanding of product lists that hitherto restricted SSIs, modifications of labor laws and of registration procedures, decentralization of decision-making, and liberalization of environmental laws applicable to small-scale units. In order to relieve the SSI sector from the shortage of working capital arising from delayed payments by large enterprises and public sector for supplies made by the SSI, an Act for the payment of interest on delayed payments to small-scale and ancillary undertakings has been enacted. In addition, priority status has been given to the small-scale sector in the allocation of iron and steel.

The SSI sector raises its term-credit and working capital from commercial banks, cooperative banks, regional rural banks, and state financial corporations. The banking system mainly provides working capital and term loans whenever feasible. The state financial corporations generally provide investment capital, but sometimes also working capital as part of a package of credit. In addition, the SSI is also assisted by the National Small Industries Corporation at the national level and the State Small Industries Development Corporations at the state level through selling or renting machinery. The Small Industries Development Bank of India was set up to provide refinancing to these units. Moreover, credit provided by banks to the small-scale units is treated as credit to a “priority sector”. The government has initiated a seven-point action plan to improve credit flows to the SSI sector. Under the plan, 51 specialized SSI branches have been opened as of October 1995. Table 8 gives data on bank credit provided to the SSI sector.

The SSI units have registered high growth rates of employment and value addition across industry groups. Furthermore, Ramaswamy (1994) finds a significant increase in labor productivity over the period 1972 to 1988, the two census years of SSI units. Moreover, the export intensity of the SSI sector is found to be comparable to that of the private, corporate sector. However, the structure of the SSI sector has not significantly changed. Relative to metal based industries, the primary material and agro-based industries have shown higher employment generation and value

addition. The latter group comprises food products, beverages and tobacco products, wood, leather, paper products, etc.

Table 8: Bank Credit to Small-Scale Industries (Rs. billion)

Year	Net Bank Credit	To SSI	Share of SSI
March 1991	1056	168	15.89%
March 1992	1121	174	15.51%
March 1993	1388	194	14.60%
March 1994	1409	216	15.30%

Source: Ministry of Industry, Annual Report, 1994-95, Government of India, p. 198

Table 9: Small-Scale Industries

Year	No. Of Units (In million) As of Dec.	Gross Output (Current prices) Rs. billion	Employment (In million)	Exports (Rs. billion)
1990-91	1.94	1553	12.53	91
1991-92	2.08	1787	12.98	139
1992-93	2.24	2093	13.40	178
1993-94	2.38	2416	13.93	253
1994-95	2.57	2940	14.65	280

Source: Economic Survey, 1995-96, p. 125.

Contrary to the general perception that the 1991 opening up of the economy through the liberalization process would be at the expense of the SSIs, this segment of Indian industry has recorded a growth rate of 10 percent in real terms in 1994-95. During the previous two years the growth rates were 7 and 5.6 percent, respectively. (Refer to Table 9 for details). These growth rates were significantly higher than the growth rates achieved by the industrial sector as a whole. The growth rates achieved by the SSI in the post-reform period suggest that reforms have aided growth in the small-scale sector. Moreover, with greater deregulation of the private sector in India and implementation of specific reforms related to the SSI, the prospects for growth would improve further.

According to the Expert Committee on Small Enterprises (ECSE), the government in the present economic scenario of globalization and competitiveness can only support, and not protect, small- and medium-sized enterprises, particularly with regard to technology, products, skills, and manpower. According to the committee, the government's responsibility was only to the weak, tiny, and cottage sector. Consequently, at best, government intervention would come only when finances to the SSI sector were held up through a faulty system of credit recovery.

Comparison

TVEs and SSIs are both small-scale enterprises with an average employment level of six workers. Although both China and India try to encourage small scale enterprises, their policy targets are quite different, and therefore the results areas well. China and India differ in the following ways:

a) While China emphasizes initial support for the TVEs, India's incentive schemes are available as long as a firm remains small-scale. China has created incentive schemes to encourage the establishment of new TVEs, and laid emphasis on the initial stage of development, that is, for the first few years. In India there is a clear-cut line that defines small-scale industries based on the kinds of assistance and preferential treatments given. Being defined as small and remaining small will ensure continued support.

Table 10: Comparison of TVEs and SSIs (1994)

	<u>TVEs</u>	<u>SSIs</u>
Total export (\$billion) ^{#1}	40.23	8.92
National Share of Exports	32.6%	33.4%
Employment (million)	113.3	14.7
Units (million)	18.67	2.57
Average Employment (Persons)	6.1	5.7
Share of National Credits	6.25%	15.3%
Loss-making units	76.8	225.3 ^{#2}
Loss-making unit share	0.41%	8.77% ^{#2}

Source: CSSB 1995, p 537, TVE Statistical Yearbook 1995, p 6, 87, 88, 100; Almanac of China's Finance and Banking 1995, p 474, 483; Economic Survey 1995-96, p 92, 125; Summary Statistics, Center for Monitoring Indian Economy, 1992.

Note: #1. Exchange rates used to convert into dollars are 8.4462 Yuan/Dollar and Rs 31.37/Dollar, the rates at the end of 1994. #2 refers to 1990 private sector SSI data.

(b) While India supports SSIs through material, financial and fiscal schemes, China uses these and, in addition, provides technical, training, and managerial support for the TVEs. China's Spark Plan was targeted to direct assistance to the TVEs, in terms of capital, management, training, etc., with a view that these TVEs, while small now, will eventually grow large and compete in the international market.

(c) China gives additional awards to TVEs that export. Since exporting is a major theme in China's economic policy, governments at various levels promote exports through which TVEs also benefit.

(d) To promote the SSIs, India reserves a list of goods for exclusive production by the SSIs. In a way, the markets for the SSIs and other firms are segmented. Market segmentation, as economic theory says, will only create market distortion and inefficiency, and

(e) As India does not allow bankruptcy, loss-making SSIs increase in number; as a result, the percentage of loss-making SSIs is significantly higher than that for China's TVEs.

Although both TVEs in China and SSIs in India have grown with these preferential policies, TVEs seem to have grown much faster. TVEs had total employment of over 113 million in 1994, while SSIs had only 1.4 million employees. While the gross output-share of the TVEs increased from 7.2 percent in 1978 to 42.7 percent in 1993, gross output-share of the SSIs remained constant between 1990/91 and 1993/94²³. Though both TVEs and SSIs account for about one-third of their national exports, respectively, TVEs have a much higher volume. Over the last decade, a large number of TVEs have grown into large enterprises.

V. Special Economic Zones in China and India

In order to catch up with the advanced countries, it is essential for less developed countries such as China and India, to adopt open door policies. Openness not only allows the country to specialize and use its comparative advantages, it also benefits the country through increased access to foreign capital, information, and advanced technology. To facilitate such flows of trade, capital, information and technology, many countries set up, in the early stage of opening up, export processing zones or special economic zones that provide preferential policies. The success of such zones usually has direct impacts on the entire economy, especially from the foreign perspective. However, the success of such zones mainly depends on their preferential policy packages. In this section, we try to study the policies adopted in the special economic zones (SEZs) in China and in the export processing zones (EPZs) and Export Oriented Units (EOUs) in India, and we compare their performances and their roles in promoting foreign trade and investment.

Before we discuss China's SEZs, it may be helpful to give a broad picture of the effect and strategies of China's open-door policies. The geographic development of China's open-door policy started in 1979 with an export processing zone in Shekou (part of Shenzhen), followed by four SEZs in 1980, and the opening up of fourteen coastal cities in 1984. Then in 1985, the government further opened up the Yangzhi River Delta, the Pearl River Delta, and the Southern Fujian Delta as economic development zones. In 1988, the fifth SEZ Hainan Province was established²⁴. Meanwhile, between 1985 and 1987, the State Council announced that fourteen economic and technological development zones (ETDZs) in twelve of the fourteen coastal open cities would have similar preferential policies as in the SEZs. In 1990, the State Council set up 26 new technology development zones with similar preferential policies to the SEZs. Then, five border cities were opened in 1992, and more and more ETDZs were authorized by the State Council or the provincial governments. By the end of 1994, most interior capital cities and major industrial cities were also opened. Now, the open-door policy has radiated first from the SEZs, to fourteen coastal cities, and many ETDZs, mostly in the coast, to the border cities, and to the interior capital cities and major industrial areas. The open areas have spread so fast that it is almost impossible to keep track of the

²³ We calculated gross output share of SSIs by using gross output of SSIs as the numerator and India's GDP as the denominator. It turns out that the share stays constant at about 33% between 1990/91 and 1993/94.

²⁴ Liu Guoguang writes: "By then, China had opened up her south east part, covering about 150 million population." Gu, Nianliang, Zhihe Yang, Hangang Gu, & Xisan Zhuang, *Regional Effects of China's Special Economic Zones*, 1989, p 2.

number of zones, area coverage, and population affected. A reasonable guess of the number of such zones in China, whatever they are called, would be more than a thousand²⁵. As a result of the success of opening up, China's foreign trade volume has doubled every five years since the reforms. The actual amount of foreign capital used increased from \$2.7 billion in 1984 to \$48.4 billion in 1995. More than 234,000 enterprises with foreign investment were registered in 1995. Such foreign enterprises accounted for 39 percent of China's total foreign trade in 1995²⁶.

Keeping this broad picture of China's openness in mind, we now look deeper into why China has been so successful by focusing on the SEZ. How did the SEZs evolve and what policies have been adopted for the SEZs? Then we will compare China's SEZs with India's export processing zones.

China's SEZs were established soon after the government began its economic reforms. In 1980, the central government approved proposals from Guangdong and Fujian provinces that both provinces have more flexible economic policies in order to promote foreign trade and investment through their location advantage and mass overseas Chinese connections. Then, four SEZs were set up: Shenzhen, Zhuhai, and Santou in Guangdong province, and Xiamen in Fujian province. Later on in 1988, Hainan Province²⁷ was also designated as an SEZ. With the immediate success of the SEZs, in 1984 and 1985, the government opened up coastal cities, and set up economic and technological development zones (ETDZs, which provide similar preferential policies). In 1992, the government opened the interior provincial capitals and border cities. After seventeen years of reforms, China has experienced an opening up spanning the south to the north, and from the east to the interior and the west, i.e., all over the country.

Given the key role the SEZs have played in China's opening up and economic reforms, we have chosen to study their economic development and the preferential policies them. All five SEZs used to be relatively poor and located in the southern part of China. However, their location advantage (close to Hong Kong, Macao and Taiwan) and connections to the outside world, to a great extent, helped the flow of information, and trade and capital, especially in the initial stages of opening up. Such changes are evidenced by increases in GDP, employment, exports, foreign capital inflows, and the number of enterprises. Shenzhen is the most successful of the SEZs. In 1979, the year prior to establishment of SEZ for Shenzhen, there were only 224 small factories; by 1989, Shenzhen City had 6,470 enterprises, and its GDP reached 9.3 billion Yuan, thereby increasing at an annual

²⁵ Since Deng's south tour, more kinds and number of zones have been opened all over the country. By the end of 1992, there were more than 2700 zones, some of them were authorized by counties or by cities which are not legal. (See Gao, Wang, & He, 1993, p 138.) However, realizing many of such zones are redundant, the central government had closed 1274 zones by the end of 1994. (See Almanac of China's Economic Relations and Foreign Trade 1995/96, p 85.) Now only zones authorized other than by the State Council or by the provincial governments are valid.

²⁶ CSSB, People's Daily Overseas Edition, March 7, 1996, p 5.

²⁷ Hainan Province was a part of Guangdong Province until 1988.

compounded rate of 47 percent for ten years²⁸. In terms of employment, the number of staff and workers (basically employment in the organized sector) was only 26,500 in 1980, but by 1991, it had increased to 648,800. The increases in foreign trade and foreign capital are even more impressive. While Shenzhen exported only \$9.3 million in 1979, the volume increased to \$3.5 billion in 1991, and to \$18.3 billion in 1994.

Basically, all five SEZs experienced immense success, as shown in table 11. While the SEZs have less than one percent of the national population, and about 1.5 percent of formal sector employment, they accounted for 3.27 percent of the national GDP, 21.8 percent of total exports, and 12.6 percent of foreign capital utilization, (which includes loans and foreign direct investment) in 1994. The success of SEZs in foreign trade, capital inflows, and economic growth quickly spread to the rest of the country: first to the open coastal cities, ETDZs and other zones, then through trading with the interior regions to almost every corner of the country. As a result, the country has experienced compound annual growth rate of 10 percent since 1978. Exports increased from \$9.8 billion in 1978 to \$148.8 billion in 1995. Foreign capital inflow increased from \$2.7 billion in 1984 to \$38.1 billion in 1995. As of 1995, 258,000 projects involving foreign investment have been approved, and 120,000 enterprises with foreign investment are operating in China, employing more than 16 million workers.

As is well known, China had a closed and centrally planned economy prior to its reforms. As economic reforms began in 1978, the Chinese government wanted to break away from the traditional economic system. Thus, SEZs were set up for this purpose, and they have been acting as economic laboratories for the market economy and bridges to the outside world. Differing from the rest of China, the economies of the SEZs depend on market forces rather than the plan. Local governments in the SEZs have more power in making regulations and approving foreign investment projects.

In order to create a competitive economic environment, preferential policies were adopted for investors, as well. In 1980, the corporate tax rate for SEZs was set at only 15 percent (Table 12) at a time when tax rates elsewhere went up to as high as 55 percent for domestic firms and 40 percent for foreign firms. Foreign investors receive extra tax benefits of two years of exemption from the date when the firm starts generating profits, followed by a 50 percent tax reduction for another three years. To promote exports, an additional 10 percent tax reduction has been set up for firms that export more than 70 percent of their products, and export duties are also exempt for goods produced in the SEZs. Import duties are exempt for equipment, parts, materials used for production purposes, and daily necessities used for consumption purposes. To show the government's determination and commitment to the SEZ policies, land was leased to foreign investors for up to 50 years (later on, it was extended to a maximum of 70 years). Land usage fees were set very low, and were exempt or reduced for from one to five years. Property taxes were also exempt for three to five years to encourage foreign investors. To attract people to work in the SEZs, individual income taxes were reduced by 50 percent of the national level; in addition, the interest income of foreigners is exempt from individual income tax. Labor mobility was also encouraged right from the beginning. Professionals or highly skilled workers were allowed to move to work in the SEZs regardless of the

²⁸ Data on Shenzhen in this paragraph are drawn from Yearbook of China's SEZs and Coastal Economic and Technological Development Zones 1980-89, p 22.

then-rigid household registry system. Workers were allowed to move from company to company, and firm managers had the right to pay employees according to their merit and even fire them, if necessary.

Table 11: China's Special Economic Zones

Names	<u>Shenzhen</u>	<u>Zhuhai</u>	<u>Santou</u>	<u>Xiamen</u>	<u>Hainan</u>	<u>National Share of SEZs</u>
Year Established	1980	1980	1981	1981	1988	
Area Coverage sq km	327.5	121	234	131	33931	0.36%
GDP (million Yuan)						
1979/1980*	196	380*	na	na	na	na
1991	17446	6045	3720	6250	10900	2.05%
1994	na	na	na	na	na	3.27%
Staff & Workers (1000)						
1980	26.5	24.1	222.1	185.1	954.5	
	1.49%					
1991	648.8 ^{#1}	185.7	368.9	277.7 ^{#2}	1077.4	
	1.76%					
Exports (mil dollar)						
1980	11	9	232 ^{#3}	140	na	na
1991	3446	699	1024	1151	670	9.73%
1994	18309	1488	2202	3389	987	21.79%
Foreign Capital Utilization (mil dollar)						
1980	27	16	na	na	na	na
1991	580	170	197	183	216	11.65%
1994	1730	763	774	1241	918	12.56%

Source: China's SEZs & ETDZs Yearbook 1980-89, 1990-92. Gao, Wang & He, 1993, p 2227. CSSB, Almanac of China's Foreign Economic Relations and Trade 1995/96.

Notes: #1 refers to 1991's data, from China's SEZs and Coastal Economic and Technological Development Zones Yearbook 1990-92, p 74. #2 is estimated according to Gao, Wang & He, 1993, p 2227 "In ten years since the establishment of Xiamen SEZ, Xiamen created 92.6 thousand jobs." #3 refers to 1982's data.

The result of such policies has been that SEZs not only succeeded in attracting foreign capital, technology, information and management skills, and increased foreign trade and economic growth, but they also trained millions of workers and managers who now understand how a market economy operates and have experience in a competitive economy. Many people also learned management skills and built up business relations with foreign partners. The indirect effects and feedback on economic reform provided to the central government and other governments are, if anything, even more profound. As we discussed earlier, it is the success of policies toward the SEZs that has led to widespread opening up of China.

Table 12: Major Preferential Policies for SEZs in China

General Guide-Lines	Corporate Tax	Individual Income Tax, Property Tax & Land Usage	Import/Export Duties
<p>1. Foreign Capital is the major source for development fund.</p> <p>2. Economic activities depend on market forces, rather than the state plan.</p> <p>3. Local governments have more power in making regulations, approving foreign investment projects.</p> <p>4. Special treatments for enterprises in SEZs: tax holiday or reduced tax rates, accelerated depreciation rates (generally 5-10 years), flexible policies on imports and exports.</p> <p>5. The amounts of fiscal revenues and foreign exchange earnings to be transferred to the central government are fixed, revenue or earnings above the quota belong to the local governments.</p> <p>6. Capital or profits of foreign investors are free to flow in and out of the country.</p>	<p>1. Corporate tax rate is 15% for enterprises located in the SEZs. No additional local tax.</p> <p>2. Profit reinvested in the SEZs are exempt from corporate tax upon application.</p> <p>3. Enterprises with foreign investment enjoy 1 to 3 year corporate tax exemption (counting from the date when firms have positive profits), and 50% reduction of corporate tax for additional 3 years.</p> <p>4. Enterprises that export more than 70% of their products are allowed 10% reduction in corporate tax.</p> <p>5. Business incomes of banks and insurance companies are exempt from industrial and commercial consolidated taxes for 5 years from their establishment. After the five-year exemption period, the tax rate is 3%.</p>	<p>Individual income tax:</p> <p>1. 50% of the individual income generated in the SEZs that is subject to Individual Income Tax Law of the People's Republic of China is exempt from individual income tax.</p> <p>2. Interest income of non-citizenship is exempt from individual income tax until 1995. (It is not known whether it is still in effect.)</p> <p>Property tax:</p> <p>Foreign investors are exempt from property taxes for three to five years for the real estate property that they newly bought or built.</p> <p>Land usage:</p> <p>1. Land is leased to foreign investors up to 70 years.</p> <p>2. Land usage fees are reduced or exempt for 1-5 years depending on various situations: used for business operation, or for production; if it introduces high technology; and whether it is developed land or not.</p>	<p>1. Import duties are exempt for equipment, parts, raw materials, transportation vehicles, and other production materials purchased by enterprises located in the SEZs for production purposes. (This policy is being phased out starting in 1995.)</p> <p>2. Daily necessity goods used for consumption purposes, except cigarettes and wines, are exempt from import duties.</p> <p>3. Exports of goods produced in the SEZs with domestic materials, except for raw oil or oil products or other products that the state has specified, are exempt from industrial and commercial consolidated taxes (and export duties?).</p> <p>4. Exports of goods produced in the SEZs with imported materials are exempt from industrial and commercial consolidated taxes.</p>

Sources: Regulations on SEZs in Guangdong province in *A Comprehensive Book of Laws and Regulations of the People's Republic of China*, 1995; China's Special Economic Zones and Coastal Economic and Technological Development Zones Yearbook, 1980-89, 1990-92; Gao, Wang & He, 1993; *A Comprehensive Book of Practical Economic Laws of China*; *A Comprehensive Book of Economy*, Vol 73, 1994.

Export Processing Zones (EPZs) and Export-Oriented Units (EOUs) in India

The export processing zones were set up as enclaves and separated from the domestic tariff area by fiscal barriers, with a view to provide an internationally competitive, duty free environment for export production at low cost. The first EPZ in India was established in Kandla in 1965. India now has seven export processing zones, namely Kandla (Gujarat); Santacruz (Bombay); Falta (West Bengal); Noida (Uttar Pradesh); Cochin (Kerala); Madras (Tamil Nadu); and Visakhapatnam (Andhra Pradesh). The Santacruz EPZ is meant exclusively for the export of electronics and gems and jewellery items, whereas the other EPZs are multi-product zones.

Each of the zones provides basic infrastructure, such as developed land for construction of factory sheds, standard-design factory buildings providing ready-built sheds, and roads, power, water supply and drainage. In addition, customs clearance is arranged within the zone at no extra charge. Promotional policies for EPZs in India are given in Table 13.

The Export-Oriented Unit (EOU) scheme was introduced in early 1981 and is complementary to the EPZ scheme. The EOU adopts the same production regime but offers a wider option of locations, with reference to factors like sources of raw materials, ports of export, hinterland facilities, availability of technological skills, existence of an industrial base, and the need for a larger area of land for the project. As of March 1995, there were 523 units operating under the EOU scheme. The EPZ operating units broadly fall under the product groups of electronics, engineering items, chemicals and allied products, gem and jewellery, textiles, garments, plastics and rubber products. On the other hand, EOUs are mainly concentrated in engineering, chemicals and plastics, granites, textiles, food processing, agriculture, aquaculture, steel, and forest products.

Exports from EOU/EPZ, which stood at Rs. 33.16 billion in 1992-93, rose to Rs. 48.59 billion in 1993-94, thus representing a growth of over 46 percent. In the case of EPZs, exports during April to November 1994 were on the order of Rs. 11.21 billion, while EOUs accounted for Rs. 16.42 billion from April- September 1994.

Under the Export-Import policy for 1992-97, the following modifications have been made: a) automatic approval under certain conditions to proposals for setting up units; b) leasing of capital goods from domestic companies by EPZ/EOUs; c) streamlining of procedures for domestic tariff area (DTA) sale and rationalization of duty structure; d) revision of the value addition formula by excluding indigenous raw materials to make value addition on the basis of net foreign exchange earnings; and e) permission for the development of EPZs by the private, state, or joint sectors. In fact, proposals for setting up two private EPZs have been cleared, and these are to be set up in Bombay and Surat. Promotional policies applicable to the EPZs have been announced by the government at different points of time.

In August 1994, the government introduced a centrally sponsored Export Promotion Industrial Park (EPIP) scheme. This was primarily enacted with a view to involving the state governments in the creation of infrastructural facilities for export-oriented production. The scheme provides that 75 percent of the capital expenditure incurred towards creation of such facilities,

ordinarily limited to Rs.100 million in each case, will be met by a central grant to the state governments. In addition, a maintenance grant equivalent to 2 percent of export turnover of each unit established therein will also be made available to the state governments for a period of 5 years from the date of commercial production of that unit. As of March 1995, the central government had approved EIPs in 10 states of the Indian union.

Table 13: Promotional Policies for the Export Processing Zones in India

General Incentives	Fiscal Incentives
<p>No upper limit to foreign ownership share, even in the non-priority industries.</p> <p>No customs duties on raw materials, components, tooling, etc.</p> <p>No import licences were required even prior to the reforms, as all imports into the zone were placed under the Open General Licence.</p> <p>Locally procured supplies from the DTA treated as exports, thus attracting all export incentives for the suppliers.</p> <p>Blanket foreign exchange sanctions for business trips abroad.</p> <p>Repatriation of capital up to the extent of original investment.</p> <p>Repatriation of profits and dividends after payment of tax.</p> <p>Duty-free imports of capital goods and equipment.</p> <p>Priority release of cement, steel, telephone, and telex connections.</p> <p>Packing credit facilities for a period of 180 days without production of firm export orders.</p>	<p>A tax holiday of five years on all corporate profits (can choose 5 consecutive years within the first eight years of establishment).</p> <p>Exemption from central excise duties on all zone manufactures.</p> <p>Exemption from central sales tax. In addition, in some zones there is exemption from state sales tax, octroi duties, property tax, etc.</p> <p>Credit is made available to the zones at preferential rates from central and state financial agencies.</p> <p>Subsidized rentals and lease rates for built-up sheds, and factory space.</p> <p>No rent is to be paid for the first two years, only 15 percent has to be paid in the next two years, and full rent has to be paid only from the beginning of the fifth year.</p> <p>Plots are leased for 30 years at Rs 10 per sq. meter per annum.</p> <p>The zone units are allowed to sell 25 percent of their output in the domestic tariff area. Some fixed percentage of the waste, seconds, and scraps can be sold in the DTA.</p> <p>Term finance at concessional rates of interest for fixed assets.</p> <p>Free remittance of profits and dividends earned by the foreign investor after taxes.</p>

Source: Annual Reports of Ministries of Commerce and Industry, various issues.

Table 14: Performance of Export Processing Zones

Name of Zone and No. Of units	Number of persons employed	<u>Exports</u>			
		<u>1981</u>	<u>1989</u> (US \$Million)	<u>1990</u>	<u>1991</u>
KAFTZ, 107	11,000	NA	203	254	173
SEEPZ, 115	10,500	NA	174	217	203
NEPZ, 71	4500	NA	31	25	29
MEPZ, 107	6616	NA	18	34	50
CEPZ, 23	2170	NA	7	3	12
FEPZ, 12	400	NA	10	14	11
Total= 435	35,186	218	443	547	478
National Exports		8704	16955	18477	18266
EPZ Exports Share		2.5%	2.6%	3.0%	2.6%

Source: Economic Survey, 1992-93, p 108, 1994-95, p s-71, s72.

The performance of India's export processing zones has been far from satisfactory, as can be seen in Table 14. EPZs in India have neither been successful in promoting exports nor in attracting foreign investment. As a proportion of total Indian exports, the exports from EPZs have more or less been constant. Despite all the incentives, the EPZs have performed rather poorly in attracting foreign investment. There are number of reasons for such disappointing performance:

(a) the objective of attracting foreign direct investment was not explicitly stated until the commencement of the Indian reforms. Since the Indian economy was highly regulated and controlled until 1991, the policy enclave nature of EPZs became stronger rather than more diffuse. The EPZs have lacked dynamism because of their relatively limited scale;

(b) the authorities wanted the EPZs to achieve multiple objectives, however, fulfilling some of these often involved trade-offs with others. In fact, at times, some of these objectives were seen to be patently unsuited to EPZs. For instance, with regard to the Kandla and the Santacruz EPZs, the objectives of developing backward regions and promoting small-scale units diverted the zones from their primary objective of attracting foreign capital and raising export earnings;

(c) The lack of infrastructural facilities has also prevented the EPZs from performing as well as they should have. Adequate infrastructure is seen to be available only in two out of the seven EPZs established so far;

(d) the facility of single-window clearance has not really been effective. The boards of the different zones do not have the power to grant clearances because they are only advisory bodies and the final orders are given by the parent departments. All the companies need to get clearance from the Secretariat of Industrial Approvals and also from the Ministry of Commerce;

(e) although all the EPZs (except the Noida EPZ), have port facilities nearby, these have not been able to attract major shipping companies; and

(f) incentives in India for the EPZ investors have almost always been announced in a piecemeal manner²⁹. Moreover, the incentives were also withdrawn at times. For the investor, such changes create uncertainty and confusion. Clearly, investors would prefer a degree of predictability in policies over a relatively long period. This could not be assured given the manner in which incentives to the zones were handled³⁰. As a consequence, the EPZs failed to attract foreign investors.

In a comprehensive study Kumar (1989) suggests that tax holidays in India have not been a very significant incentive for attracting foreign capital, in fact, they have ranked below other measures such as single-window clearance and healthy labor relations. Tax holidays are not attractive for two reasons. First, because it is difficult for a unit to start earning profits within one or two years of its establishment. Second, multinational corporations use transfer pricing to reduce their taxable income in the host economies. While tax holidays for the first five years are not an attractive incentive, in any case these too were introduced in India for the first time in 1980. In the mid-1980s, however, this incentive was redesigned and entrepreneurs were given the option to choose five consecutive years within the first eight years of establishment to avail of this holiday. Among other things, Kumar suggests the setting up of an EPZ Authority to ensure single-window clearance, a uniform set of incentives for all the zones, and for planning, establishing, promoting, and efficient running of the zones.

Comparison:

The performances of China's SEZs and India's EPZs have differed vastly. Data provided in Table 11 for the former and Table 14 for the latter provide evidence to this effect. While the SEZs of China had export earnings totaling \$6,990 million in 1991, the six EPZs of India put together had exports of a mere \$478 million. In fact, Hainan SEZ, (with the lowest export earnings among the five SEZs in China) at \$670 million, was by itself 40 percent higher than what all of the EPZs in India put together exported in 1991. In addition, Chinese SEZs have also created far more employment opportunities than their counterparts in India. Shenzhen alone employed a higher number of persons in 1991 than all the EPZs put together in India. Furthermore, when comparing the foreign capital inflows in the zones of the respective countries, one finds that China is far better placed than India. While foreign capital inflows amounted to modest sums until 1991, they have witnessed a tremendous jump in 1994. By contrast, the EPZs in India have failed to attract foreign investments of any sizable sum.

²⁹ On this issue, the Tandon Committee (1982) remarked in its Report that "our problem has been the ad-hoc granting of incentives.....", p. 88.

³⁰ The Tandon Committee (1982) suggested that "a comprehensive package of incentives should be provided and then advertised as a lasting offer instead of piecemeal sporadic exemptions, concessions, and relaxations of the past.....", p.68

Several reasons account for the poor performance of EPZs in India compared with the commendable performance of SEZs in China. First, while the SEZs in China were established with a view to attracting foreign capital and promoting Chinese exports, in India, EPZs had numerous objectives. Some of these were patently unsuitable for an export processing zone. The objective of attracting foreign direct investment was not explicitly stated until the commencement of the reforms in India.

Table 15: Comparison of SEZs and EPZs (1991)

	SEZs	EPZs
Total Exports (\$million)	6990	478
Share of National Exports	9.7%	2.6%
Employment (000's)	2558.5	35.2

Source: Table 11 and Table 14.

Second, the EPZs in India are much smaller in size than the SEZs in China. Moreover, China developed a comprehensive package of incentives for the SEZs soon after their establishment. In contrast, incentives for the Indian EPZs have almost always been announced in a piecemeal manner. Also, incentives in China for SEZs cover a much wider arena of preferential policies than is the case in India.

Third, the provincial and local governments in China have a much greater say in the formulation of regulations and in the approval of foreign investment projects. In India, on the other hand, the states are severely constrained by the lack of power in this regard, that is, only the central government has the authority to devise regulations or approve projects.

Fourth, the strategic Chinese policy of locating the zones in Guangdong and Fujian provinces has paid rich dividends. With geographical proximity to Hong Kong, Taiwan, and Macao and the connections with the overseas Chinese, the SEZs had easy access to foreign capital, technology, and information. The investments made by the overseas Chinese in the early years of the SEZ establishment led to a situation in which investments then started pouring in from other parts of the world. Needless to say, no such comparative advantages existed in the case of EPZs in India.

Finally, foreign investors have not been comfortable with the 75 percent export obligation requirement in India that was in place until the beginning of reforms. Although the incentives offered by India and China are comparable, the results achieved by the SEZs in China and the EPZs in India are vastly different. China has, in fact, followed a flexible policy with regard to export obligations. In the post-reform period, however, India too is moving towards more liberal and flexible policies.

VI. Concluding remarks

In this paper we have attempted to compare the post-reform scenario in China and India with respect to a few selected issues of industrial policy. Reforms in China are much older than they are in

India, and hence a comparative analysis helps us derive lessons relevant to India from the experiences of China. Notwithstanding the fact that there are a number of differences between the two economies, however, there are significant similarities as well that make a strong case for comparing the two.

A comparison of economic development in the two countries shows that macro economic conditions in China are much better than in India. While China's population growth rate has been much lower than India's, its growth rate as far as the labor force is concerned has been higher. In addition, China's urban unemployment rate has been kept low. China also has more than a 50 percent higher rate of savings and investments than India. Although China was rather closed to the outside in 1979, it now is more open than India, with more foreign capital inflows and a higher foreign trade volumes. While China's debt ratio and debt service ratio are both within safe limits, this is not the case in India. During the last decade and a half, China's GDP growth rate has been more than double that of India's; but on the other hand, China's inflation rate has remained in double digits.

In the area of deregulation, our findings suggest considerable gains for China's non-state sector. With extensive price reforms, particularly in agricultural commodities, there was a boom in the agricultural sector. The surplus income of the farmers was invested in TVEs, which led to a flourishing rural industry. And with the relaxation of restrictions on labor mobility, surplus agricultural labor made full use of the choices that were available, that is, one could either set up businesses anywhere one wanted or take up employment in urban or rural industry. By contrast, while labor mobility has not been a problem in India, price controls certainly have. Although the government has decontrolled prices of a number of industrial products in the last five years, a large number of agricultural commodities continue to have state-administered prices.

The area of restructuring and liquidation of firms is also one where China has moved far ahead of India. While legal and regulatory obligations in India do not permit firms to restructure or close down if need be, the same is feasible in China in the non-state sector. Stringent labor and land laws in India are major hurdles that get in the way of restructuring firms. In the absence of flexibility on these fronts, it is only natural for foreign firms to look to other locations for investment purposes. Deregulation of the private sector in India is therefore tremendously important if India is to perform as well as China has done.

Our comparison of China's TVEs with India's SSIs shows that, while the former are supported by the state in their initial stages of development for the first few years, the latter continue to take advantage of the incentives as long as they remain small (per the official definition of a small-scale firm). Since a plethora of incentives are offered to the SSI, firms tend to remain small-scale in order to enjoy the advantages of being small, unless, of course, they see larger profits in crossing over the dividing line. By and large, the tendency of the small-scale firms in India has been to stay that way in order to reap all the benefits. Second, the policy of item-reservation for the SSI needs to be done away with. Apart from causing distortions, this policy has done little else that is positive: in fact, the number of items reserved for production in the SSI has gone up considerably - from 47 items in 1967 to as many as 836 in 1995.

Our comparative analysis of SEZs in China and EPZs in India suggests that, while both countries have offered more or less a similar package of incentives, the former have been much more successful compared to the latter. Among other things, this is particularly true for foreign investment flows, export earnings, and employment generation. Ironically, while India established her first EPZ in 1965 compared with China's initial efforts in 1980, the Indian EPZs never seemed to take off -- either in attracting investment or promoting exports. As discussed earlier, the overseas Chinese based in Hong Kong, Macao, Taiwan, and in other South East Asia countries played a crucial role in the success of the SEZs in China.

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