Agriculture and Trade in China and India

Policies and Performance since 1950

EXECUTIVE SUMMARY

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with contributions from

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Contents of the book *Agriculture and Trade in China and India*

Preface

The world's two most populous countries, China and India, are currently engaged in an attempt to liberalize and revitalize their economies after decades of state control. Although the two nations adopted different political systems in the 1940s—communism in China and democracy in India—they followed similar development strategies from the early 1950s through the 1980s. In both countries, the state was the engine of development, and planning guided economic decisions. Now each is faced with undoing decades of government control, regulation, and ownership of economic enterprises.

China began its economic reforms in 1978 under Deng Xiaoping. Since then it has gradually allowed for greater individual initiative by farmers and businesspeople and has conducted a number of experiments in liberalization in various regions of the country. Productivity in the country has risen dramatically.

India did not begin reforms until 1991, and then only in response to economic crisis. Facing high debt, high inflation, increased oil prices, and the possibility of default on foreign loans, the government made far-reaching changes to the system of foreign trade and payments.

The authors of the book *Agriculture and Trade in China and India* look carefully at the economic history of these two countries since 1950 to determine how the vital sectors of agriculture and trade influenced development. In both countries agriculture accounted for most of the employment and output in 1950 and gradually gave way to industry. Now China and India are discovering, as are many other developing countries, that trade offers great promise for growth if they can harness its potential by competing successfully in world markets. As yet both countries are still struggling to make their export products competitive, and T. N. Srinivasan, Justin Yifu Lin, and Yun-Wing Sung assess the future prospects for the two countries. If they succeed in liberalizing their economies and reaping the benefits of trade, they will serve as important examples to the many other countries, such as those in the former Soviet bloc, that are embarking on this same path. More important, China and India can, together, improve the lives of nearly half the world's population.

This publication is an executive summary of *Agriculture and Trade in China and India.* The International Center for Economic Growth is pleased to publish that important work, which offers valuable insights for scholars and policy makers around the world.

Nicolás Ardito-Barletta
General Director
International Center for Economic Growth

Panama City, Panama
December 1993

Summary of Conclusions

China and India, the most populous and among the poorest countries of the world, have attempted since 1950 to improve their economies and alleviate poverty through similar development strategies but under vastly different political frameworks. Both have undertaken major economic reforms, China beginning in 1978 and India in a piecemeal fashion in the 1980s and comprehensively since 1991. An analysis of their successes and failures is of great relevance to the developing world.

Agriculture and Trade in China and India: Policies and Performance since 1950, outlined in this executive summary, compares, and contrasts where appropriate, the Chinese and Indian policies and performance with respect to agriculture and foreign trade.

The development strategies of both countries gave primary importance to industrialization in general and to the development of heavy industry in particular. The continuing importance of the agricultural sector as a source of employment for an overwhelming majority of the labor force in the two countries is in part a reflection of the failure of the development strategy of both countries to generate productive employment opportunities outside of agriculture.

China is still a dictatorship, while India is a representative democracy with regular elections to the national parliament and the state legislatures. Until the death of Mao Zedong in 1976, China was a command economy in which private producers and markets played insignificant roles in resource allocation and factor accumulation. India is a mixed economy with a large private sector and functioning markets. China began moving away from the command system in 1978 with the introduction of the household responsibility system in agriculture and the development of export-oriented special economic zones in coastal areas. The large industrial state enterprise system, however, has yet to be reformed significantly, although smaller rural and township enterprises have grown rapidly. India also began liberalizing its economy, hesitantly and to a limited extent, in the early 1980s. In 1991 the government of Prime Minister P. V. Narasimha Rao embarked on a bolder, coherent, and mutually consistent set of reforms in several sectors of the economy.

India and China had roughly the same level of per capita income in the early 1950s and had experienced similar growth in the previous fifty years. It is widely accepted, however, that real gross national product (GNP) per capita grew much faster in China than in India after 1950. In the 1980s overall economic growth, as well as the growth of exports, was much faster in China than in India. China was far ahead of India in 1990 in social indicators such as life expectancy, infant mortality, and adult literacy. The apparently superior performance in terms of social indicators and the greater success of reforms in China compared with India call for an examination of their development strategies and their economic reforms.

Agricultural Reforms. In China, land ownership was collectivized in phases. The traditional farming institution of small, independent family farms and a few large landlords was transformed in stages into "people's communes" of around 5,000 households, with the subsistence needs of households, rather than the work contributed by them, becoming the dominant consideration in determining remuneration of each member. The coercive measures and new compensation system significantly reduced the incentives for work and encouraged free riding. The resultant shortage of grain led to the deaths of 30 million people. Although both China and India had experienced periodic famines in their long history before World War II, India has had no famines since independence.

Even this monumental tragedy, however, did not lead the Chinese regime to abandon communes but only to delegate management tasks in each commune to much smaller units called "production teams." The production team remained the basic farming institution until the reforms of 1978 introduced the household responsibility system.

In India, before independence, land ownership was extremely concentrated, and layers of intermediaries between the tiller and the state laid claim to the produce of land. Soon after independence, the Indian Parliament enacted laws ordering widespread changes in tenure, in permanent farming rights, and in the size of individual landholdings. Although most of the land reform laws proved to be ineffective, there appears to have been a reduction in the concentration of the distribution of land owned as well as land operated. In 1966 the National Commission on Agriculture officially recognized a long-standing reality: The organization of production in small peasant farms run with household labor, supplemented with labor exchanged with other households and occasional hired labor, was the most appropriate agricultural system under Indian conditions.

Although institutional changes, such as changes in land tenure, evolved differently in the two countries and there were differences as well as similarities in their agricultural policies, their overall performances did not differ greatly. The rate of growth of agriculture in India and China is modest and less rapid than that in some other low-income countries, such as Pakistan, Indonesia, and Kenya.

Foreign Trade Reforms. Until the reforms of 1978, Chinese foreign trade was monopolized by nine national foreign trade corporations. The profits and losses of these corporations were absorbed by the Treasury. Neither the producers nor the corporations had an incentive to be cost-conscious and efficient. Foreign trade policy shifted with the ideological winds. The country did not exploit foreign trade to achieve efficient development based on its dynamic comparative advantage.

From the 1970s on, foreign trade was no longer viewed as a necessary evil, but as an essential ingredient in modernizing the Chinese economy. Although controls on exports, imports, and foreign exchange transactions remained, exports of all goods and services, and particularly of manufactures, rose rapidly and impressively. The mechanisms used were special economic zones in coastal areas, the provision of incentives (such as foreign exchange retention), tax rebates, direct subsidies on planned exports, and above all the effective use of the exchange rate.

India's development strategy has three broad objectives: economic growth, self-reliance, and social justice. It assigned the state a dominant role in development and made key industries such as railways, telecommunications, and electricity generation the exclusive responsibility of the public sector. Planning has been driven by the perceived need to conserve foreign exchange expenditures.

Since foreign trade was largely in the hands of the private sector, the government established an elaborate system for controlling and allocating foreign exchange. The complexity of the system led to a wide range of implicit exchange rates across the spectrum of imports and exports, with associated efficiency losses.

The foreign exchange and investment licensing system also led to corruption, politicization, and rent seeking in the processing of license applications. The import control regime has confined imports to essential consumer goods, raw materials, and investment goods needed for domestic production and exports. The composition of India's exports has shifted moderately away from primary products to manufactured goods. Yet a diversified and dynamic export sector has not emerged.

There were several attempts to liberalize or reform the system of economic management; however, all of these attempts involved modifying some aspects of the system of bureaucratic and discretionary control over industry and foreign trade and payments without changing the system in a fundamental way. The reforms announced in June 1991 were forced on the government by an unprecedented financial crisis and can be viewed as attempts to make fundamental changes in the system of economic management.

The immediate stabilization measures included an austerity budget and a devaluation of the rupee, while the government made clear its intention to address long-term structural problems through reform of the control mechanisms on foreign trade and private investment, taxation, the financial sector, and public enterprises.

The reforms are too recent, however, to have had any significant impact. The short-run measures to contain the acute foreign exchange crisis were successful, but this was due not to any permanent improvement in the fundamentals of the balance of payments, but primarily to the return of confidence of the nonresident Indians in the Indian economy and support from multilateral donors.

Unlike the Chinese regime, the Indian government has to convince the opposition in Parliament, the press, and labor unions about the need for and the gains from reforms. The Rao government lost its parliamentary majority early in 1993 when one of its regional allies withdrew support.

It is cause for concern that the cost and quality of output (in most, if not all, cases) is not internationally competitive, certainly in India and perhaps in China. The Indian industrial and input licensing system encouraged the creation of small-scale, high-cost plants in many industries and sheltered them from internal and external competition. Most of the industries in the public sector have yielded negligible returns. It is doubtful whether the protected capital goods industries in the two countries have accumulated the dynamic learning experience to bring about significant technical improvement in the equipment they produce.

Both economies, however, have succeeded in building a diversified industrial structure. Both produce a far greater variety of industrial goods, including capital goods, than most other developing countries. They depend to a much lesser extent on imported equipment, and their scientific and technological capability is evident. Both have so far avoided accumulating a heavy foreign debt, although India has become the fourth largest debtor, after Brazil, Mexico, and Indonesia, among developing countries. China has succeeded in eliminating abject poverty and improved the education, health, and literacy of its population, an achievement which is neither nullified nor completely explained by the authoritarian character of the state. Although India's achievements are less impressive, they are nonetheless significant.

Contents

An Overview of *Agriculture and Trade in China and India*

In the economies of both China and India, agriculture provided employment to over 60 percent of the labor force as recently as 1990. Agriculture is also a significant source of raw materials for processing industries and for exports. Policies with respect to foreign trade have been central to the industrial development of both economies.

Chinese Agriculture

Traditional agriculture in China until the socialist revolution of 1949 had been characterized by small, independent household farms. Under the land reform program which spread across the nation by 1952, the government confiscated land from landlords and rich peasants without compensation and gave it to poor and landless peasants. Individual household farms were then collectivized in progressive stages.

The first type of cooperative was the "mutual aid team" in which 4 or 5 neighboring households pooled their farm tools and draft animals and exchanged their labor on a temporary or permanent basis, with land and harvests belonging to each household. This evolved in stages into the collective farm, or the "advanced cooperative," in which all means of production were collectively owned. Remuneration was based solely on the amount of work each member contributed. The size of an advanced cooperative evolved to include all 150–200 households in a village.

Collectivization was surprisingly successful in its initial stage, and this encouraged the leadership to take a bolder approach. The "people's commune" was introduced in the fall of 1958; and within only three months, 753,000 collective farms were transformed into 24,000 communes, consisting of 120 million households, over 99 percent of total rural households in China. The average size of a commune was about 5,000 households, with 10,000 laborers and 10,000 acres of cultivated land. Payment in the commune was made partly according to subsistence needs and partly according to the work performed. The right to withdraw from the collective was eliminated.

The commune movement ended in a profound agricultural crisis between 1959 and 1961. The dramatic decline in grain output resulted in a widespread and severe famine. Thirty million people died of starvation and malnutrition. Communes were not abolished, but from 1962 agricultural operation was divided. Management was delegated to a much smaller unit, the "production team," which consisted of about 20 to 30 neighboring households. But despite rapid increases in modern inputs and improvements in varieties in the 1960s and 1970s, the performance of agriculture remained poor. Grain production barely kept up with population growth.

Frustrated by its inability to improve the welfare of the Chinese population substantially after thirty years of socialist revolution, the government initiated a series of sweeping reforms.

- Beginning in 1979, the long-repressed government procurement prices for major crops were adjusted.

- The collective system was replaced by a new household responsibility system which resulted in remarkable growth in the first half of the 1980s. This system was created initially without the knowledge or approval of the central government. It was worked out spontaneously by farmers themselves and spread to other areas because of its merits. Full official recognition of the system as a universally acceptable farming institution was given in late 1981.

- A greater role was given to markets and market considerations, in place of planning, for guiding production in the rural sector. In 1985 the state declared that

> it would no longer set mandatory production plans, including targets that had forced an increase in cropping intensity and the expansion of grain-cultivation area at the expense of cash crops. A decision was made to increase grain imports, cut down grain procurement quotas, and reduce the number of products covered by planning.

The restoration of household farming and the increase in market freedom prompted farmers to adjust their production activities in accordance with profit margins. Grain production and the agricultural sector as a whole registered unprecedented growth between 1979 and 1984, and the overall living standards of both urban and rural populations improved substantially. The success of these reforms encouraged China's political leaders to undertake a series of more market-oriented reforms at the end of 1984 in both the urban and rural sectors.

Grain production, however, stagnated after reaching a peak in 1984. Most people in China, including political leaders and economists, believe that China should be self-sufficient in grain. Poor grain production prompted a call for more conservative, plan-oriented agricultural policies, perhaps even re-collectivization, with the ostensible goal of pursuing economies of scale in agricultural production. But a less costly policy would be to rely on comparative advantages and allow the nation to produce other labor-intensive crops in exchange for part of the grain requirement through international trade. Although China's rural institutional reforms may have become irreversible, poor performance in grain production will always be a political issue in China.

Collectivization did have a favorable impact on income distribution among individual households in rural areas. The major source of income differences in China, however, is regional disparity—the unequal distribution of climate patterns, natural resources, urban centers, markets, and transportation—and these differences cannot be eliminated by means of collectivization. The most important disparity is the gap in living standards between the urban and rural population, a problem that was implicitly acknowledged by the government when it prohibited rural-to-urban migration.