

# Factors which made Chinese Economy more developed than Indian Economy

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**Abstract**—This study compares the economic growth trajectories of India and China, exploring the factors contributing to China's rapid expansion and examining India's potential for similar, or even greater, growth. Beginning with a shared economic landscape in the late 20th century, the paper analyzes why China's economy significantly outpaced India's. The research investigates the roles of education, investment-led growth, foreign direct investment (FDI), and the effectiveness of local governance. It examines the arguments presented by economists like Raghuram Rajan and Daves Kapur, who highlight the importance of basic education, strategic investment, attracting FDI, and incentivizing local governments to promote economic development. The study explores why India, despite liberalizing its economy, has not achieved the same level of growth as China, focusing on challenges related to local government capacity, the influence of the caste system, and the complexities of premature democracy. Finally, the abstract concludes by considering the recent improvements in India's infrastructure, education, and local governance, suggesting that India may be well-positioned for significant economic growth in the coming decades, particularly given its young and growing population.

**Keywords:** FDI, investment, China, trade.

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## I. INTRODUCTION

The rapid economic growth of China over the past few decades has been a subject of intense study and, more recently, a source of both admiration and concern as its pace slows. This research delves into the comparative growth trajectories of India and China, seeking to understand the factors that propelled China's remarkable economic expansion and exploring the potential for India to replicate, or even surpass, that success. While both nations shared similar economic starting points in the late 20th century, China's economy now dwarfs India's. This study aims to answer critical questions: What specific elements contributed to China's economic boom? What obstacles have hindered India's growth in comparison? And, crucially, what strategic adjustments can India make to unlock its full economic potential and potentially outpace China in the coming years? By examining secondary sources, including academic journals, books, census data, and reputable online publications, this analysis will explore the complex interplay of education, investment, foreign direct investment (FDI), and the crucial role of local governance in shaping economic outcomes. Ultimately, this research seeks to provide insights into the dynamics of economic growth in developing nations and offer a comparative framework for understanding the future of the Indian economy in a rapidly changing global landscape.

## II. RESEARCH METHOD

This research is Descriptive study and data is collected from the secondary sources of articles published in the journals, books on the themes of economic growth, websites, and census surveys. Reports relating to Economic growth of India and China that come on the newspaper and are published on Internet are also taken into consideration.

## III. OBJECTIVE OF STUDY

To compare the growth rate of India and China.

To know what factors lead to faster growth of economy of China as compared to India?

To know the improvements that India can make in its economy to surpass China's economy.

Comparing China and India by GDP: If we compare the economies of India and China as in the graph shown by the website of [statisticstimes.com](http://statisticstimes.com) the graph and data shows that in 1980 china's and India's economies started approximately the same size China soon left India far behind becoming roughly five times its size however now China's economy is slowing down western companies moving its factories else ware it could be now India's turn to replicate China's growth. This is the question which is keeping the world and India lately. To do this there could be standard answers that India should reduce corruption, liberalize it economy even more, increase education and infrastructure. To understand this we could read the works of Raghuram Rajan ex governor of Reserve Bank of India (The Third Pillar) and the works of Davesh Kapur as to why Chinese economy took off in 1980's and India's did not. First let us see the works of Prof. Raghuran Rajan to answer the question why chinas economy took off after the Liberalization of 1980's and 1990's? Why China's path will never work for India? Whether India will soon be able to pull of its own growth? Problem with India is not it did not know what to do but it failed to implement its strategy due to its own unique political structure in which there is under staffed local governments which cater to local interests. Let us now understand Why China outgrew in the first place? Prof. Raghuran Rajan writes in late 1970's Chinese workers had better level of education than the Indian counterparts. Better level of education caused the China's transition from agricultural society to manufacturing power house as it is today. To boost economic growth China started attracting various foreign manufacturing companies in 1980's and 1990's factories that required its workers basic level of education so that they could follow basic instructions. Basic education in accounting enabled a lot of these workers to later start their own companies. But there were large number of countries having basic education in 1980's so it could not be the only reason for its economic growth and able to attract foreign factories and encourage its own workers to become entrepreneurs. Another point is that China liberalized its economy in 1980's and attracting foreign companies and local entrepreneurs. This was indeed the necessary condition for economic growth but there were a number of economies which were liberalized which include India but could not replicate the growth of China. India liberalized in 1991 and later further liberalized in 2000 India's economy grew faster but could not grow as fast as Chinese economy. One may say that India did not liberalize enough it may be true. But China is still a very restricted place to do business today scoring similar points with India. When we compare the two countries Index of economic freedom in 2024 For India it was 52.9 and for China it was 48.5. So to explain the massive divergence between India and China there are some other factors. There are some ingredients in Chinese economy that india was not in a position to reproduce despite its best intentions. The next ingredient that propelled Chinese growth was what Prof. Michael Pettis of *Peking University and a senior associate of Carnegie Endowment* calls Investment-led growth this is the growth model which was at the heart of growth of countries like USA, Germany, Japan and was later adopted by China. The idea of Investment Led growth is that in 1980 both India and China had a huge under Investment problem well they have a population that could be productive they are held back by lack of Infrastructure, knowledge and assets as machinery so to grow at a miracle level speed a poor nation simply needs to invest at miracle levels in infrastructure and other productive assets but the question is where does the money come from in a poor country perhaps it is never a problem as country could print as much of money as needed and could spur the unemployed workers into action. The central government cannot spent all the money productively, to prevent inflation they have to outsource this money to commercial banks who create the money as debt. That money will not produce inflation and will not produce debt GDP as long as it is used to grow the economy. To ensure that the Chinese banks would invest in infrastructure and factories, china ordered its local and state owned banks to direct credits to infrastructure and factories (manufacturing) at low interest rates. While this could explain that because of state intervention, China has too much of Infrastructure and too much of Factory capacity this was done while china was still a developing country. What about India, why did India not follow the Investment led growth model and investment in factories and infrastructure. While actually it did,

it liberalized its corporate sector but kept its banking sector in the hands of the state. It is just like China. Banks invested in infrastructure and industry led tycoons unlike China's business tycoons India's tycoons did not spend the money productively and by 2013 while China's corporate concurred the world India's corporate were failing and highly indebted to a state banking system that was about to collapse. Although after this India's investment has got better a recovery that was partly made possible by Prof. Raghuran Rajan who was Governor of Reserve Bank of India helped to clean lot of these bad debts. A lot of credit also goes to Prime Minister Mr.Narendra Modi who came in power in 2014 and made a lot of investment in infrastructure. India's growth and investment has not been bad at all but not as miraculous as of China.

Getting FDI: Attracting foreign factories/corporate or we can say FDI. FDI gets its name from if you are building a factory i.e directly investing. China was in a position to get foreign direct investment where as India was unable to get that the desired amount of FDI. FDI comparisons from 1990 to 2022 of India and China it is seen that India's FDI were much less as compared to China. One can see the comparison from the UNCTAD's website. Why is attracting FDI was so important ? and why was India not able to do this for this we would go to 1980's both countries were lacking infrastructure and machines but also knowledge of how efficient factories operate knowledge that you cannot learn in school, knowledge that is accumulated by working in efficient factories. This is why attracting foreign factories became important as it added to local knowledge. This added to China's economic growth. On top of that as local money is infinite in theory printed by local banks and central banks, foreign money like US dollars can be used for crucial exports such as German machines as it was used by China. So attracting FDI is a key ingredient for fast growth, it enhances local knowledge and increases the US dollars required for crucial exports. China's basic education was also very important to get FDI as we have already discussed. But according to Prof. Rajan there is a difference between India and China and that is how their local governments functions. Both the economies are decentralized systems on a massive scale it is important to note getting education, investment led growth and attracting FDI right is not something that is determined at the top but it is determined at the local level to implement the changes. To do this local governments need the right incentives to stimulate local investment and FDI . The Chinese local governments had the right incentives. Local governments of China were all part of Communist Party they would be promoted or demoted not by the fact that they would be liked by local population or how were they liked by the boss or loyal to the boss, but how much they were able to grow their local economy. On top of that a large part of local government's revenue was to be raised by land sales and the value of land appreciates when right infrastructure is built. This way local governments could increase their revenue. Local Chinese government was keen to make things as easy as possible for foreigners who wanted to invest in Chinese cities. For example as Prof. Raghuram Rajan describes in his book, " *The Third Pillar*" when an Indian businessmen wanted to invest in China he was met at airport by the deputy major, taken to visit the site on same day and then was immediately taken to majors office where all the necessary paper work had already been filled out any problem raised could be delt with the local government. When Elon Musk came to China he was able to have his Sanghi factory up in running in a record time because local Sahghi officials cleared all legal obstacles for him. In contrast to India where central government ensured that India is a great destination for FDI, the local governments often frustrated the foreign firms by strictly upholding India's strict regulations and making it time consuming to get around them. In summary as Prof. Rajan puts that China was in a position to grow initially because it had better level of education and well both liberalized their economies only China could Invest in a colossal scale and was able to direct FDI to supercharge its economic growth. It was not that Indian government was not aware that it needed to attract FDI that its local governments did not play along while in China Local governments had right incentives to promote Local Investment and FDI. If we turn to the work of Prof. Davesh Kapur it would be clear that local governments hold india back in the past were even doing the same till date. Prof. Kapur has identified three explanations as to why local governments did not play the right part in increasing investment:

1. **Local Governments:** Local governments of India are understaffed as compared to China which increased its local government capacity during its growth. Structure of India's employee count is opposite of China in China most employees work at Local level only few at state or federal level in India it is other way round most of employees work at State level and federal level few at local level. This could explain why local governments could not help foreign investors on the rules on the same scale as China. But if this was the only factor it could be improved by funding the local governments and helping them to higher more people . this will not solve the problems. This is because there are number of posts unfilled in India at local level to the worst some of the local governments do not spend the money given by the central government. So this brings us to the second explanation given by Prof. Kapur.
2. **Caste System of India:** This divides the Indian population in social hierarchies based on their birth. Despite laws have been made against Caste system it still is prevalent in many parts of country. Caste system can explain dysfunctional local governments in 3 different ways:
  - a. Realizing that caste system was stronger at local government level India's founders on purpose made sure that local governments are not too powerful , they were intentionally kept weak.
  - b. Even if the local government has adequate capacity they might not have the adequate incentives to implement policies of central governments because it is not in line with the caste system. For example Prof Kapur puts it quiet a level of education programs of centre where schools were to improve the education of girls, failed at the local level because prof kapur puts it " what happens within the classroom is affected by caste and gender norms"
  - c. Sabotaged vacancies: Caste system often leaves some of the vacancies open because candidates are from higher castes. For example in the book "the Narrow Corridor" written by Daron Acemoglu and James A Robinson describe how in Bihar several vacancies for engineers were not filled besides unemployment because those qualified to become engineers belong to higher caste as the Chief Minister Lalu Prasad Yadav belongs to lower caste so he refused to fill these positions. As a consequent everyone suffered as the government of Bihar was severely understaffed as a result it could not spent all of the money allocated by centre to upgrade local infrastructure.
3. **Premature Democracy:** Third problem that India could not raise its FDI was its democracy. Now democracy in itself not a problem because in well function democracies; democratic process in itself could give local governors its incentives to spend in local economies. If you do development you have a better chance to be re-elected as local governor again. Indeed democracy has produced vast majority of growth ranging from West Germany, Japan, Italy to USA. Unlike these examples Prof. Kapur claims that India is a Premature Democracy meaning that country became democratic before it was perhaps ready to become democratic. Prof. Kapur gives 3 reasons why this is holding India back:
  - a. Vicious bad service tax cycle: a premature democracy can get into a vicious cycle in which it serves poor public services like education and health care at a time when it is established as a consequence wealthier people will exit public system and start using private schools and hospitals and therefore they are less willing to pay taxes; making local government services even more dis-functional. Indeed Prof Kapur notes that local governments reluctant to raise taxes the taxes they need to improve their cities .
  - b. Rewards for divided voters not public: Another reason that premature democracy is holding back is that India is so divided that local governments elected by specific castes/ religious group or by any other interest group tend to prefer rewarding their voters by giving them subsidies or other specific benefits rather than to invest in public services that can be enjoyed by all.

- c. Emphasize highly visible goods: Finally premature democracy politicians will tend to emphasize on public goods that are highly visible goods and relatively easy to provide for example they might spend in hyper modern metro's rather than to improvise its education system which results will be seen only in few years time. It happens in every democracy but more so in premature democracy.

India did not grow as fast as China because it lacked basic education, did not invest as much as China, could not attract FDI as much as China. Deeper reason is that India's local government did not have the capacity or the right incentives to improve education and to attract FDI due to lack of personnel, wrong incentives provided by caste system and India being a premature Democracy. However with the Modi government things are improving though pace is slow. But now India is catching up with China people are now better educated as compared to 1990's infrastructure has seen a major upgrade especially on digital and financial side. Foreign companies are looking up for an alternative to China; India is in theory really positioned to attract FDI. Professor Kapur puts it that a successful implementation various programs as opening Bank accounts, gas connections and toilets. All these point out that the local governments capabilities are improving markedly. Now India is well positioned to its growth in upcoming decades. Finally primary education which is responsibility of local governments has increased this could mean that more Indians will have access to unprecedented wealth of online material such as online lessons this will focus learning by doing and they will become hands for economic growth as India has got the largest number of population which is young.

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