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Action Based Research

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Winter 2010-Independent Study

Instructed by Professor Tammy Feldman

A large portion of the content of this research paper has been removed due to the confidentiality of the information. The following section represents the final section of the research paper, focusing only on China and India.

An Economic Analysis of China through Academic and Action Based Research:
China and India

The World's Giants

According to the World Development Indicators of 2008, the world contains approximately 6.69 billion individuals. 1.32 billion live in China and another 1.14 billion live in India. Together, China and India make up 2.46 billion members, or approximately 37%, of the entire human race¹. Yet with such a significant amount of human capital, comprising such a large proportion of our world's population, the countries have only recently drawn the amount of worldwide attention they deserve. Investors worldwide, from micro-financing to automobile manufacturing are seeing the potential that exists within these two countries. However, in order to be able to conduct business with China and India, it is extremely crucial to understand the differences that exist between them. Political, geographic, and social differences, stemming from governmental structure to cultural traditions, create both opportunities and barriers to businesses and investors who wish to utilize these two countries for their immense market potential. By visiting China, and studying India in great-depth, I have been able to gain an understanding of the two countries, and by analyzing the experiences I have had, and the academic research that I have done, I have been able to develop an analysis of two most populated players in the world market, their past, their present, and the potential changes that exist for them in the future.

Political Science 101

A country's economic growth depends largely upon its governmental organization and how such a government both encourages and discourages investment, both domestic and abroad. The political structures that have evolved throughout China and India are extremely different with reference to both

¹ "Google - World Development Indicators."

their abilities to create policies and their abilities to implement the policies that are created². Although political reform is beginning to arise within the Chinese nation, the current government of China is highly centralized, and the majority of the legislative decisions of the country rest in the hands of the President³. China's highly centralized form of government, combined with the country's communist ideology that, be it the one-child policy, the Tiananmen Square Massacre, or the censorship of Google, allows the country to implement policy changes without worrying about the backlash that could result from its people—at least not when compared to India. India currently has an extremely decentralized form of government, which is also based around much more democratic ideology than is that of China⁴. Having been under British Colonial Rule, and restructured around decentralized governmental planning, the country facilitates both policy-making and policy implementation on a much more democratic level⁵. An example of this can be seen through the development of Panchayati, which are small governing powers elected by villagers, whose role is to help make political decisions and better represent the members of the community.⁶

Abnormal Development

Because of such political differences, the two countries have differed greatly with their economic growth over the past 50 years, with India constantly lagging behind China, with a GDP/capita increase from 1960 to 2005 in China from \$105 to \$1451, compared to that of India, from 1960 to 2005 from \$180 to only \$590⁷. Such differences have resulted in drastic gaps between the two countries' manufacturing, agricultural and services industries, which can be clearly seen through the shifts that have occurred over the recent decades. The normal shift of a developing nation is to move from

² "Governance, decentralization, and ... - Google Books."

³ Ness, *India and China: Urbanization*.

⁴ Ibid.

⁵ Trauttman, "History of India."

⁶ "Decentralization in India."

⁷ *World Development Indicator*.

agriculture to manufacturing to services⁸, a shift that China has completed successfully. As time passes, farmers begin performing skilled labor, manufacturing sectors emerge to exploit the inexpensive labor who, until then, knew only how to farm. Skilled laborers then transition, as education increases, to enter the services industry, and the agricultural and manufacturing sectors move to other, more affordable, locations of human capital. This can be seen in China, where the GDP value added from agriculture declined from 22.32% in 1960, to 12.55% in 2005⁹. During these same 40 years, manufacturing reached its peak percentage in 1980, of 40.48% but then declined to 33.48% in 2005, as the percentage of value added GDP of the services sector took over, increasing from 21.39% in 1980, to 40% in 2005¹⁰. India, on the other hand has not completed such a shift, but rather, has essentially “skipped” the manufacturing stage of the transition, and instead has drastically increased its value added GDP from services, which has increased from 37% in 1960, to 52% in 2005¹¹. During this same time period, the percentage of value added GDP has remained relatively stable, only increasing in value as GDP increased, rather than increasing as a percentage of GDP, which would be expected in a “normal” transition. Such an increase in services can be derived from the increase in jobs that have been outsourced to India, by the more developed countries. Services include jobs such as customer service, appointment scheduling, and even virtual personal assistants.¹²

Job Theft

The significance of this “skip” has led the country to fall short in the manufacturing sector, which is essential to a country’s overall industrial development. The manufacturing sector, be it through textiles, electronics, or other goods involving assembly lines, provides the infrastructure that is needed

⁸ Gayle Ness, “Population, Development and the Environment.”

⁹ *World Development Indicator*.

¹⁰ Ibid.

¹¹ Ibid.

¹² Meredith, *The Elephant and the Dragon: The Rise of India and China and What It Means for All of Us*.

to help bring the agricultural worker into a skilled labor position¹³. Normally, without this stage, the infrastructure in the country lacks the necessary means to turn the “agricultural people” into educated “services people”. However, in India, the country’s former status as a British colony enabled much of the urban areas of India to be well-versed in the English language¹⁴. Thus, English speaking people in India were able to enter the services industry without having been involved with the manufacturing stage that most developing countries’ citizens would otherwise have to transition through. However, those who were not fortunate enough to be involved in the services industry remained in the agricultural sectors of the economy—essentially, farmers teaching their children to farm. This created a gap between the agriculture and service stage. However, when the agricultural sector of India declined over the past 50 years, as a percentage of value added GDP from 42% to 18%¹⁵, people who knew only to farm, who could not enter the services industry due to their lack of English (having been part of the more rural population), had no place to go. A large enough manufacturing sector did not exist, as there had never been a need to exploit inexpensive Indian labor that could be more easily found in China. During the past century, China was able to essentially “steal” all the manufacturing away from India, while India had a head start on the services industry. Now, however, as India attempts to establish an industrial revolution, they are faced with the conundrum due to the gap that was created over the past 50 years. Thus, poverty remains a larger problem in India than in China, and as Chinese citizens are becoming more educated, the services sector in China continues to increase, essentially “taking back” the services jobs from India. However, given that the manufacturing sectors in China are still as prominent as ever, and the population of China is such that allows for a steady supply of individuals entering the manufacturing sector, there has been little “stealing” of manufacturing jobs moving from China to India, and thus, India’s gap remains.

¹³ Gayle Ness, “Population, Development and the Environment.”

¹⁴ Meredit, *The Elephant and the Dragon: The Rise of India and China and What It Means for All of Us*.

¹⁵ *World Development Indicator*.

Connecting the Dots

But how did such a gap emerge? One of the main reasons that the “stealing of jobs” occurred was due to the centralized Chinese government that was explained earlier. A more centralized government has enabled China to swiftly implement policy changes that are conducive to employment of its citizens. As goods became produced in China, the country allowed the exploitation of its people at extremely low wages, setting up special economic zones in the 1970’s, free of taxes and rent¹⁶. Foreign direct investment boomed, and the manufacturing sectors in China brought its citizens through the second stage of the normal economic development transition, moving from agriculture into manufacturing. China remained the most opportune environment in which to place manufacturing jobs, and with few regulations revolving around the well-being of Chinese citizens, they remained easily exploited, yet easily employed.

India currently is attempting to bring the country into as “revolutionized” a position as is China; however, with its decentralized form of government, it is finding it difficult to disregard the rights of the citizens to promote big business¹⁷. This can be easily observed through current land disputes. The citizens of rural India inhabit large plots of land scattered throughout the country. Through villages, towns and farms, these citizens, who are almost always unwilling to move, present huge problems for the Indian country as a whole. The land on which they reside provides potential development of schools, factories, roads etc. Politicians will not support the idea of evicting voters, and in the past, riots have broken out protesting eviction efforts that business have pushed the government to implement. Two hundred proposed factories, railroads, highways, and other projects that are currently locked up due to such land conflicts could account for over \$98 billion in investment. Projects that could create jobs for farmers, schools for undereducated towns, roads for villagers to gain access to hospitals, and

¹⁶ “ScienceDirect - World Development : Special Economic Zones and the Opening of the Chinese Economy: Some Lessons for Economic Liberalization.”

¹⁷ Srivastava, “What’s Holding India Back.”

trains that could improve commerce, are being limited due to the lack of centralization within the government. Such a lack of centralization prevents the government from implementing the policies necessary to evict the citizens, promote infrastructure, and create jobs. The service employment opportunities that currently exist, prevalent as they may be, do not provide enough jobs needed for India's 1.3 billion individuals, and if the nation wishes to reform, it will have to do so by freeing up the land, and literally building from the ground up.

Finding a Way

Among the many companies that have struggled with the current development of India, there are some companies who have been able to cope with the country's current circumstances. One company, in particular, has been able to successfully operate within both the Indian and Chinese economy. As explained earlier, China's economic emphasis currently lies in its manufacturing sector, while India's lies in services¹⁸.

*"...at GE healthcare, Chinese hardware marries Indian software. The 719 parts of a high-end Proteus radiology system were developed in GE facilities in a dozen countries. Development of software algorithms and the scanner's generator took place in Bangalore, and final assembly was done in Beijing...."*¹⁹

GE is an example of a company who has been able to cope with both India's lack of manufacturing strength, and China's lack of services capacity. They have been able to utilize both dynamic advantages of each country, and actually sell their healthcare product in both the Chinese and Indian markets. GE was unable to manufacture their product outside of China, or develop the software outside of India, at a low enough cost that would allow them to still sell the final product to the Chinese

¹⁸ Meredit, *The Elephant and the Dragon: The Rise of India and China and What It Means for All of Us*.

¹⁹ Khanna, *HBS Case Corporate Bridges: Linking China, India, and the West*.

and Indian markets. The company adapted to the local environments in which they desired to operate, and presented a successful business model that will probably be mimicked by others in years to come.

Supply then Demand

Be it governmental regulation, or economic transitions, companies have found ways to adapt to the varying factors that create both the Chinese and Indian economies. The two countries have developed on extremely different paths, largely due to the political compositions that have encouraged specific economic growth in some sectors, and inhibited growth in others. With almost 40% of the world's population, as China and India learn to utilize their populations as leverage, and overcome the infrastructural shortcomings that currently exist today, their influence in the world economy will have the potential to not only provide the services and manufacturing that the world demands, but will end up shaping the manufacturing and services demands of the world.

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