international conflict from the perspective of the individual leader.

3 Bueno de Mesquita et al., 2003.
4 "Timeline: Kenya: A chronology of key event," March 5, 2005; "Corruption haunts Kenya's Leader," February 23, 2005; "Poll Blow for Kenya's New Rulers," December 31, 2004. http://news.bbc.co.uk/.
5 Easterly 2002.
6 Smith and Vreeland 2005.
7 Bueno de Mesquita and Root 2002.
8 A parallel phenomenon is the resource curse. Abundant natural resources provide revenues that ensure that leaders can satisfy their supporters' demands for private goods. With the political risk associated with an economic crisis alleviated, leaders can become more expropriative.
9 Vreeland 2004.
10 Bueno de Mesquita and Smith 2004.
11 Sachs 2005.

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Ashutosh Varshney

China and India: A New Asian Drama

With the economic rise of India and China, a new question has entered the international public sphere: How will the polities of India and China be shaped by their continuing economic march over the next decade or so? More specifically, will politics get in the way of their steady economic rise, or will political liberalization continue as the market forces are embraced ever more vigorously? Will economic liberalization, in short, promote further political liberalization? This question is more relevant to China than to India, where economic liberalization has been pursued within the framework of a long-established democracy.

The last question, in principle, can be extended to much of Asia, including Indonesia, which, after the Asian financial crisis of 1997–98, is slowly crawling back to a higher economic growth path as well as moving forward democratically, and Malaysia, whose economic growth of the last thirty years is propelling it toward the status of a high-income country, though it is not clear that Malaysian polity will allow greater political freedoms to its citizens any time soon. While Asia in general is attracting notice again, the international public sphere—corporate headquarters, diplomatic capitals, and journalistic circles—is now especially buzzing with India-China comparisons. As Lee Kuan Yew, the "father" of Singapore and one of the most visible figures and authoritative voices in Asian diplomatic circles, recently noted in an international conference in Singapore, India and China, because of their sheer size and potential capabilities, raise issues that the general rise of other Asian nations since the 1960s simply could not.[1] Between them, India and China have almost 40 percent of the world's population. A great domestic economic transformation of these two countries, therefore, also has major international implications.

What can academic specialists of development say beyond what one hears in the public sphere? Let us begin with a brief factual survey of economic developments in the two countries. There is a consensus now in economic circles that both India and China have turned a corner. China since the early 1980s and India since 1991 have been shedding regulatory controls and embracing international openness. Both successfully weathered the Asian financial crisis in 1997–98.[2] On the whole, for the last twenty-five years, India has been growing at roughly 6 percent per annum and China at 8–9 percent per annum. In corporate circles, China is now viewed as a capital of the world's manufacturing, and India, with the

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development of an internationally competitive information technology (IT) industry, as a service capital of the world. Although there are criticisms in India that the pace of reforms could be quicker and the growth rate higher, approximating China's, observers now firmly believe that reforms are irreversible, India's economic environment has qualitatively changed, and a considerable economic momentum has been generated, which one should in any case expect from a roughly 6 percent annual growth rate maintained over more than two decades. Of the 133 countries for which the World Bank provides statistics, eleven economies registered a growth rate of over 6 percent per annum during 1990–2000.[3] India and China were the only two with a massive economic size, making a 6 percent growth rate highly significant in relative terms.

All short-run economic indicators currently put China ahead of India: a huge inflow of foreign direct investment; a greater privatization of the state sector; investment rates at about 44–45 percent of GDP versus India's 23–24 percent; trade/GDP ratio of 70 percent versus India's 25 percent; and so on. The serious issues for the long-term future, however, concern the economic and political institutions of the two countries.

Let us begin with the economic institutions. Two differences, though they are by no means the only ones, stand out: India has developed world-class corporations, whereas China has not, and India's capital markets are significantly more developed.[4] This institutional map of the economy has a clear history behind it. Post-independence India overregulated entrepreneurs, but a private sector was always allowed to exist. Business houses such as the Tatas are over a hundred years old. Communist China did not allow private companies between 1949 and 1978, so those private firms that now exist are no more than 20–25 years old. The same is true of the capital markets. This institutional divergence goes a long way toward explaining why China's growth is widely viewed as factor-driven, based on the mobilization of capital and labor, not efficiency-driven. India may have a considerably lower investment rate, but its incremental capital output ratios, compared to China's, are lower too, suggesting greater efficiency in resource use.

Will China have to worry about economic efficiency at some point? Will the relative underdevelopment of firms and capital markets seriously constrain its economic march? It has recently been argued that lack of world-class firms might constitute a significant problem for China in the coming years, slowing it down seriously,[5] but it seems unlikely that economic institutions will be the biggest hurdle for China's progress. The reasons are not hard to identify. While the house of the Tatas may be over a hundred years old, several world-class companies in India, especially those in the IT sector, are not more than 25–30 years old. Infosys, India's most prominent IT firm in international corporate circles, was born in 1981 with a few hundred dollars of initial capital. In 1998 it was the first Indian company to be listed on NASDAQ and in late May had market capitalization of over $18 billion. Such cases of quick learning and achievement are not uncommon in the business world. Similarly, capital markets can also be significantly improved reasonably quickly.

The greatest institutional hurdle for China's future is political. China may have undergone increasing economic liberalization, but its polity continues to be marked by a Communist monopoly over political power. Local-level elections have been allowed, but only between candidates chosen by the Communists. Being a democracy for over fifty years, India has an institutionalized system for letting political power change hands. Those who win the elections form the government. Indeed, incumbency has become a disadvantage in Indian democracy. Three out of four governments have been voted out in the last twenty years at the federal and state levels. Elections have become India's institutionalized political common sense, and transfer of power between different political parties or alliances is a regular political occurrence.

Will the Communist power monopoly be challenged in China? It is highly probable that government will face a serious challenge in the next decade or so. Two sources are easy to identify: rising inequalities, especially between the urban and rural parts; and a substantially richer and huge middle class that the most remarkable economic transformation of our times is giving birth to. A tipping point may be triggered by an exogenous shock—for example, a banking crisis, an environmental disaster, a serious local-center clash, an act of egregious brutality or corruption by the Communist party—which could lead to the party's split.

Rural protests in China against the local government machinery are now regularly reported. However, rural protests in and of themselves may not pose an insurmountable obstacle for Beijing. China's huge economic resources can be deployed to deal with possible large-scale rural unrest. Moreover, as is well known, due to inherent collective action problems, rural unrest tends not to become organized nationwide. Rural protests become potent only if combined with a split within the ruling party or the state.

Though China scholars often call attention to the rising localized unrest of the peasantry or industrial workers,[6] the urban middle class may well turn out to be equally, if not more, critical. All societies that have gone through a market-based growth rate of 7–9 percent per annum for nearly three decades witness the emergence of a strong middle class. China's Communist Party has begun to absorb some of the newly rich purely on grounds of pragmatism. While such a strategy can work in a city-state, a country 400 times as large as Singapore cannot possibly achieve a Singapore-style politics of middle-class containment. Is a quiescent 500 million strong middle class, whose incomes are based increasingly on private sector activity, even possible?

Over time, the middle classes begin to look for political freedoms, often to protect recently acquired private property from unpredictable state behavior. Urban disaffection has been on the rise in China.[7] Sooner or later, China's rulers will have to face the prospect of middle-class unrest, which may also be accompanied by a split within the Communist Party.

China's rulers will have two options: refashion the Communist party on democratic lines à la Hungary and Poland, or crush the unrest à la Tiananmen Square.[8] China's Communists are not likely to take the route of democratic transformation. Communist parties in East and Central Europe had failed both economically and politically, losing legitimacy comprehensively. In comparison, China's economic success, under the tutelage of the Communists, is beyond doubt. This phenomenon continues to give the Communist party considerable legitimacy in many quarters, and the party is unlikely to give in the same way as the Eastern and Central European Communist parties did. China's Communist party is not a clay-footed colossus, even though it is to be expected that it will lose legitimacy among important sections of the rising middle class. A strong and independent middle class and a quite powerful state are thus likely to exist together. This kind of structural situation is more conducive to a confrontation than to a capitulation by the ruling party.

In short, a Tiananmen Square–like dénouement is more plausible. The external situation also makes it more likely than a democratic transformation. The unresolved status of Taiwan and China's historical animosity with Japan had no parallels in the post-1989 East and Central Europe. Faced with an internal rebellion, China's rulers are quite likely to use the external threat for internal legtimation and for an excuse not to make a democratic transformation. They will ask citizens a standard political question often used by ruling parties in such situations: What is more important, the nation or political liberalism? Liberalism rarely wins in a clash with ferocious nationalism.

However tempting a Tiananmen Square–like response may be for the Chinese rulers, it will not be as easy to discipline the nation that way. China had a very small middle class sixteen years ago, when the Tiananmen Square rebellion was suppressed. The middle class is much larger now—and much richer. Expect serious turbulence in China and East Asia in the next decade.

Notes

1 Lee Kuan Yew 2005.
2 Primarily because capital accounts were not fully liberalized, only current accounts were.
3 World Bank 2002.
4 Other critical issues include India's more solvent commercial banks and provisions for the owning of private property. In China, farms still cannot be owned privately; they can be leased from the state, which is legally the owner of all farming land.
5 Huang and Khanna 2003.
6 Gallagher 2005.
7 Ibid.
8 On the democratization of the Polish and Hungarian Communist parties, see Grzymala-Busse 2002.

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