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THE IMPACT OF CHINA AND INDIA ON THE DEVELOPING WORLD

RAPHAEL KAPLINSKY*

The global economy is undergoing a profound and momentous shift. The first half of the 21st century will undoubtedly be dominated by the consequences of a new Asian dynamism. China is likely to become the second biggest economy in the world by 2016, and India the third largest by 2035. A cluster of other countries in the Asian region, such as Thailand and Vietnam, are also growing rapidly. These newly dynamic Asian economies can collectively be characterised as the “Asian Drivers of Global Change”. The economic processes they engender are likely to radically transform regional and global economic, political and social interactions and to have a major impact on the environment. This is a critical “disruption” to the global economic and political order that has held sway for the past five decades. It is reshaping the world as we know it, heralding a new “Global-Asian” era.

Role of China and India for global change

As mentioned above, the two key Asian Driver economies are China and India. But they reflect very different growth paths. China is integrated into an outward-oriented regional economy, involving fine divisions of labour in many sectors. By contrast (at least until now) India represents much more of a “standalone” economic system. Yet, notwithstanding these differences in structure, they pose major and distinct challenges for the global and developing economies, for six major reasons.

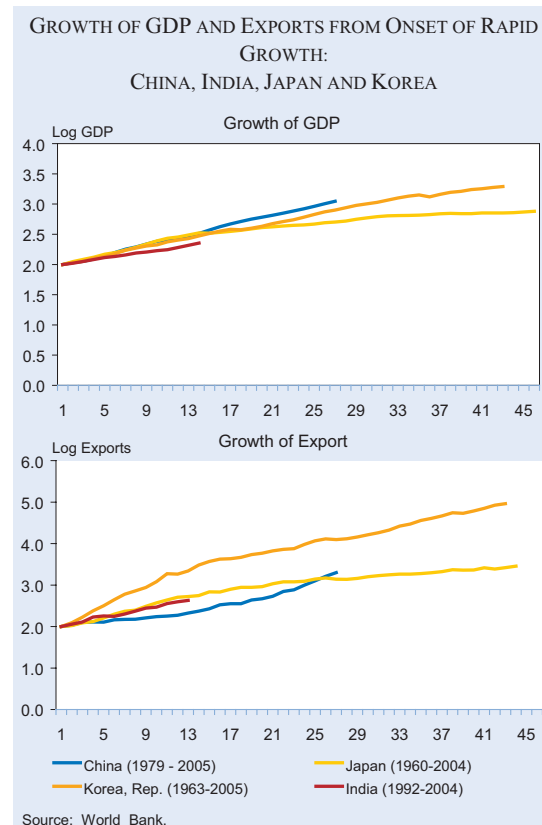
The first is as a consequence of their size. As Figure 1 shows, from the beginning of their growth spurts (1979 and 1992, respectively), neither GDP or export

growth in the two largest Asian Driver economies were unique. In recent years other Asian economies (for example, Japan and Korea) have experienced similarly rapid growth paths. However, whilst China accounted for 20 percent of the world’s population and India for 17 percent in 2002, at no time did the combined population of Japan and Korea’s exceed four percent of the global total (Figure 2). So, unlike the case of Korea and Japan who could grow without severe disruption to the global economy, we have to suspend the “small-country” assumption in the case of the Asian Drivers. The very high trade intensity of China’s growth makes the big-country effect particularly prominent in its case. Between 1985 and 2005, China’s exports rose from \$50 billion to \$772 billion, transforming China into the world’s third largest trading nation.

Second, China (especially) and India embody markedly different combinations of state and capi-

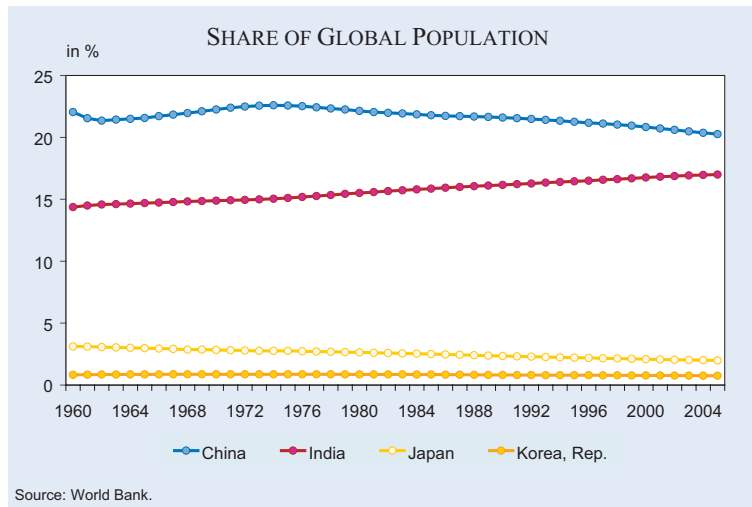


Figure 1



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Figure 2



talist development compared with the industrialised world. Chinese enterprises have their roots in state ownership, usually arising from very large and often regionally-based firms (Nolan 2005; Shankar 2005). They reflect a complex and dynamic amalgam of property rights – “The ownership of each of China’s large SOEs [state owned enterprises] has spread gradually among a variety of public institutions, each of which has an interest in the firm’s performance ... [b]ased on the “ownership maze” and vaguely defined property rights” (Nolan 2005, 169). With access to cheap (and often subsidised) long-term capital, these firms operate with distinctive time-horizons and are less risk-averse than their western counterparts (Tull 2006). Indian firms are probably less distinct from the western model, although they tend to be less specialised and often include elements of social commitment which are largely alien to western firms (Humphrey, Kaplinsky and Saraph 1998). Associated with these complex forms of ownership and links to regional and central state bodies, Chinese firms often operate abroad as a component of a broader strategic thrust. This is particularly prominent in China’s advance in Sub-Saharan Africa (SSA) in its search for the energy and commodities required to fuel its industrial advance (Kaplinsky, McCormick and Morris 2006).

The third reason why the Asian Drivers present a new and significant challenge to the global and developing economies is that they combine low incomes and low wages with significant innovative potential. This means that they are able to compete across the range of factor prices. The oft-stated belief (and hope?) that China will run out of unskilled labour is belied by the size of its reserve

army of unemployed, estimated at around 150 million compared to the 83 million people employed in formal sector manufacturing in 2002 (Kaplinsky 2005). As Shenkar observes, “China’s enormous labor reserves, with pay scales radically lower in the hinterland than the coast and in urban areas (the average income on the farm, where more than half of the Chinese population lives, is less than \$25 per month), creates the equivalent of a country within a country; so, instead of Vietnam or Bangladesh replac-

ing China as a labour-intensive haven, Hunan will replace Guangdong” (Shenkar 2005, 134). Moreover by 2030, India, also with a large reserve army of underemployed, is likely to have a larger population than China. But China and India are not content to operate in this world of cheap labour and mature technologies, and are investing heavily in the building of technological capabilities. China, for example, overtook Japan to become the world’s second largest investor in R&D in 2006.

Fourth, China and India are associated with very different forms of regional integration. China is part of a distributed regional network of production, reflecting wider regional competitiveness. Traded goods ‘manufactured in China’ usually emanate from regional production systems – China’s trade deficit with East Asia grew from \$4 billion in 1990 to \$40 billion in 2002, and the region’s share of China’s merchandise imports grew from 55 to 62 percent in the same period (Lall and Abaladejo 2004). An increasing proportion of China’s trade involves the processing of imported raw materials and intermediates (widely referred to in the literature as “verticalised trade”, see Feenstra 1998). Official data show that this form of trade grew to \$404.8 billion in 2003 (48 percent of the total trade volume), up from \$2.5 billion in 1981 (5.7 percent of total trade) (NiHaoOuZhou_com 2006). By contrast, Indian exports are more an outcome of a “national system of production”, so that the spread effects of the growth paths of these two Asian Driver economies are likely to be very different.

Fifth, both China and India are now heavily engaged in global institutions, but whereas India has long been a participant, China’s global presence is more

recent. Whilst the nature of their political engagements with the rest of the world differs sharply, they increasingly affect global and regional governance (Humphrey and Messner 2006). India plays a major role as an “advocate” of the interests of the developing countries, for example as the leader of G22 within the WTO. China is pushing the Shanghai Cooperation Organisation (formed by China, Russia, Kazakstan, Kirgistan, Tadjikistan and Uzbekistan) as a significant player in the area of global energy policies. China and India also provide a different policy role-model for many developing economies, with the possible rise of a “Beijing Consensus” to rival the Washington Consensus. These dynamics represent a transition from a quasi-unilateral US-dominated world order to a multipolar power constellation. This could lead to new turbulences and conflicts between the rising and the declining powers within the global governance system (Humphrey and Messner 2006).

Finally, China and India have huge and rapidly-growing energy needs. China is already the second largest emitter of greenhouse gases (only exceeded by the US) and by 2015 its energy demand is expected to roughly double, and India’s to rise by 50 percent. The world’s biocapacity will be severely stretched if it is to feed China’s and India’s resource hunger and sustain their growth.

The impact on low income economies: Key issues

Thus, the Asian Drivers are clearly likely to have a major impact on the global economic, political, social and environmental economy. But it is only relatively recently that their impact on low income economies has been specifically problematised. Here we can identify five distinct development-related questions

1. What are the consequences of the emergence of the Asian Drivers for economic growth in other developing economies and regions?
2. Who are likely to be the losers and winners from the growing dynamism of the Asian Drivers, within and between low-income economies and regions?
3. How should developing countries engage with the global economy in general and the Asian Drivers in particular?
4. What effect will the shift in global power in institutions of regional and global governance and in private and non-governmental organisations have on developing countries?
5. Given the enormous resource and energy hunger of the Asian Drivers, what are the environmental consequences for other developing countries?

Assessing the impact of the Asian driver economies on the developing world

How might we assess these impacts? We can distinguish three sets of structuring principles to aid this analysis – the channels of Asian Driver interaction with the global economy; the distinction between complementary and competitive impacts; and the difference between direct and indirect impacts.

Channels of interaction

There are a variety of different channels through which individual countries interact with other economies, in their regions and elsewhere. Clearly, these channels are contingent – they change over time, and vary in importance depending on factors such as location, resource endowment, trade links, and geo-strategic significance. Six key channels stand out in importance.

The first of these are the trade links between the Asian Drivers and the global economy. China’s share of global merchandise trade had risen to 6.7 percent by 2004, exceeding that of Japan, and growing particularly rapidly from the mid-1990s, a period in which the US’s share of merchandise trade fell appreciably (Table 1). By 2004, China’s share of global manufacturing exports had risen to 8.3 percent, still below that of the US and Germany but growing rapidly. By contrast, India’s share of global merchandise trade was basically stable in the same period, at a much lower level than China’s. However, India’s share of global service trade, particularly IT services grew (although no clear comparative data are available).

The second major channel of interaction is FDI. Already the Asian Drivers account for the major share of global inward FDI, with China and Hong Kong alone attracting almost 40 percent of total FDI destined for developing countries (UNCTAD 2005). But the Asian Drivers are increasingly also a source of outward FDI. In some regions – SSA in particular (Kaplinsky, McCormick and Morris 2006) – China has become the major source of new inward FDI,

Table 1
World merchandise trade by region and selected economy
 (% share of total)

	1948	1953	1963	1973	1983	1993	2003	2004
United States	21.7	18.8	14.9	12.3	11.2	12.7	9.9	9.2
Europe	31.5	34.9	41.4	45.4	43.5	45.4	46.1	45.3
Japan	0.4	1.5	3.5	6.4	8.0	9.9	6.4	6.4
S. and C. America	11.4	9.8	6.3	4.3	4.4	3.0	2.9	3.1
Africa	7.3	6.5	5.7	4.8	4.5	2.5	2.4	2.6
Asia	13.6	13.1	12.4	14.9	19.1	26.1	26.1	26.8
China	0.9	1.2	1.3	1.0	1.2	2.5	6.0	6.7
India	2.2	1.3	1.0	0.5	0.5	0.6	0.8	0.8

Source: Kaplinsky and Messner (2007).

particularly in economies which because of their political fragility, have been shunned by western investors for some years. There are four primary types of FDI – technology-leveraging, resource-seeking, market-seeking and cost-reducing. Chinese outward investment clearly fits into the first three of these – technology leveraging investments in the US (and, to a lesser extent, the EU), and resource-seeking and market-seeking investments predominantly in other developing economies.

The third channel is finance. Large trade surpluses in both China and India coupled with these countries' ability to attract FDI and other categories of capital flows have led to a build-up of large foreign reserves, estimated at more than \$1 trillion in 2006. A significant change in how Asia's capital surpluses are managed could cause an abrupt adjustment in the US interest rates and the dollar and thereby destabilise the entire world economy. It could also accelerate a slow-moving structural change which is the gradual weakening of the role of the dollar as the world's main reserve currency. Both of these developments have significant indirect implications for other developing countries, affecting the structure of global financial markets and the competitiveness of their exchange rates.

The fourth channel of interaction arises in relation to institutions of global and regional governance. The emerging strategies of China and India towards the multilateral institutions such as WTO, UN, World Bank and IMF, and the global climate regime and the bilateral interactions between the US, Europe and the Asian Drivers will profoundly change the international context for other developing countries (Chan 2006; Messner 2006). This could create new

options for developing countries if China and India were to play the role of "voices of the South" in global politics. However, if they look primarily to their own interests, new conflicts between the Asian Drivers and other developing countries might arise. China's close cooperation with "difficult states" like Sudan, Myanmar, Uzbekistan, and Zimbabwe and its close energy partnership with Iran provoke tensions with western countries and demonstrate that the Asian Drivers are able to alter geo-strategic maps and north-south relationships (Humphrey and Messner 2006).

Migration from the Asian Drivers and interactions with diaspora communities represents a fifth channel of impact. To some extent, migration is already a "fact" of considerable importance with large Chinese and Indian diasporas in Asia. Outward migration from India to SSA occurred during the late 19th century and first half of the twentieth century, and in the latter twentieth century extended to Europe, North America and Australasia. But more recently, Asian Driver migration has risen, particularly from China to SSA. For example, by some counts, there are currently more than 200,000 Chinese living in South Africa, who are mostly recent migrants. The Chinese population of Lusaka grew from 3,000 to more than 30,000 between 1995 and 2005 and Chinese migrant communities are increasingly prominent in many African countries, including from poor regions in China.

The sixth and final major channel of impact on other economies arises from environmental spillovers. Rapid growth in China and India consumes natural resources and generates cross-border environmental damages within the Asian region. Problems with the use of natural resources are widely documented. For example, there have been repeated denunciations of the activities of illegal Chinese timber logging companies in Myanmar. It is estimated that between one third and one half of acid rain in South Korea and Japan is the result of sulphur dioxide emissions from China (Umbach 2005). Beyond that, China's and India's rapidly rising imports of natural resources from all over the world are creating environmental problems in

Africa, Latin America and the rest of Asia. The most important global environmental impact of rapid growth in the two Asian giant economies will be their contribution to global climate change. China's share of worldwide CO₂ emissions could reach 25 percent in 2025, the corresponding figure for India being 10 to 15 percent.

Complementary and competitive impacts

Simplistically, and as a starting point, the interactions between the Asian Drivers, the global economy and individual regions and countries can be seen in a binary framework as comprising a range of complementary or competitive impacts. Table 2 provides some examples, notional, but informed by the emerging nature of Asian Driver expansion. In each of these channels of interaction, we can observe a mix of complementary and competitive impacts. For example, with regard to trade, the Asian Drivers may both provide cheap inputs and consumer goods, and be a market for the exports from other developing countries. On the other hand, imports from the Asian Drivers can readily displace local producers. In relation to FDI, the Asian Drivers may either be a direct source of inward FDI or crowd-in FDI from third countries as parts of extended global value chains. But the Asian Drivers may also compete with other economies for global FDI. The rising power of the Asian Drivers in a western dominated global governance system may strengthen the voice of developing countries in international organizations. The emerging conflicts between the Asian Drivers, the

US and Europe on energy, resources and markets might also marginalize development policy issues in world politics. Similarly, financial flows, environmental spill-overs and migration may be either complementary or competitive.

The key element of these interactions is the "for whom" component. Countries may be affected differentially – in some cases, for example, the export of fabrics from the Asian Drivers may feed productively into a vibrant clothing and textile value chain; in other cases, it may displace a country's exports and production for the domestic market. But these effects are not just felt at the national and economy-wide level. They affect groups within countries differentially. For example, cheap clothing imports from China may displace clothing and textile workers, but cheapen wage goods and hence reduce wage costs for producers in other sectors, which is indeed what has been occurring in many high-income economies during the early years of the 21st century. These impacts on a complementary-competitive axis may also change over time, and most importantly, they will vary for different classes, regions and groups within economies.

Direct and indirect impacts

The complementary-competitive axis of impacts is readily comprehended and widely recognised. Less widely acknowledged is the distinction between direct and indirect impacts. In part this is because the indirect impacts are difficult to measure. However, in many cases, the indirect impacts may in

Table 2

Examples of complementary and competitive impacts

Channels	Impact	Nature of links
Trade	Complementary	Imports of cheap consumer goods from Asian Drivers; Exports of commodities to Asian Drivers
	Competitive	Imports from Asian Drivers displace local producers
FDI	Complementary	Inflows of FDI from Asian Drivers
	Competitive	Competition for US FDI from Asian Drivers
Finance	Complementary	Loans from Asian Drivers to governments and private actors
	Competitive	Low-cost finance from Asian Drivers displaces local financial intermediaries
Global Governance	Complementary	Support for Development Round from Asian Drivers in WTO
	Competitive	Asian Drivers side with EU in WTO
Migration	Complementary	Asian Driver migrants intermediate complementary trade with home countries
	Competitive	Asian Driver migrants displace local entrepreneurs
Environment	Complementary	Asian Drivers cooperate in regional water projects
	Competitive	Asian Drivers as significant motors of global climate change

Source: Author's elaboration.

Table 3
Examples of direct complementary and indirect competitive impacts on Lesotho

Channels	Impact	Direct	Indirect
Trade	Complementary	Asian Driver fabrics used in Lesotho's clothing exports	
	Competitive		Asian Driver competition in US squeezes out Lesotho clothing exports
FDI	Complementary	Asian Driver investment in Lesotho's clothing sector	
	Competitive		US foreign investors relocate clothing factories from Lesotho to China
Finance	Complementary	Asian Driver aid for budgetary support	
	Competitive		Asian Driver led realignment of currencies forces up the value of the rand, and undermines profitability of Lesotho's clothing exports
Global Governance	Complementary	Budgetary support to government augments state power	
	Competitive		Asian Driver input into WTO removes AGOA preferences
Migration	Complementary	Chinese migrants facilitate imports of cheap consumer goods	
	Competitive		Chinese migrants squeeze out local traders
Environment	Complementary	Indian solar technologies enhance energy efficiency in rural areas	
	Competitive		Asian Driver carbon emissions lead to global warming and reduce rainfall in SSA

Source: Author's elaboration.

fact be much more significant than the direct ones. Table 3 gives some examples, for purposes of illustration contrasting direct complementary impacts with indirect competitive impacts in Lesotho, a poor SSA economy. In 2000 to 2004 Lesotho's clothing exports to the US under the African Growth and Opportunity Act (AGOA) scheme grew very rapidly, but were undermined in 2005 to 2006 by Chinese competition following the removal of MFA quotas (Kaplinsky and Morris 2006). Looking at the trade channel, thus, direct complementary impacts included the supply of fabrics used in Lesotho's clothing exports. On the other hand, the indirect impact on Lesotho of China's growing competitiveness in the US led to a 17 percent fall in exports during 2005. Whilst some of these exports arose from Taiwanese-owned plants, in other cases potential foreign investors in Lesotho preferred to manufacture clothes in China (as well as India and Bangladesh). Lesotho suffered badly from the appreciation of the

rand (to which its currency was tied), an indirect impact of Southern Africa's burgeoning commodity exports to China. Lesotho also stands to lose from China's accession to the WTO and the power it might wield in removing preferential access to major markets for the exports of least developed countries, outweighing any possible positive impact of potential budgetary aid to government. Finally, Lesotho's major export other than clothing (vulnerable to Asian Driver competition) and unskilled migrant labour is its water. A change in rainfall patterns consequent on global warming is likely to have very adverse economic impacts.

As in the case of the complementary/competitive access, the impact of the direct and indirect impacts can be gauged either at the country level, or at intra-national levels, for example with regard to different regions, sectors, classes and genders.

Conclusion: There is much that we don't know

The rapidity of the rise of the Asian Driver economies means that we are only beginning to recognise the enormity of their likely impact on the world economy in general, and low income economies in particular. We know that this impact is likely to be large. We also know that this impact can be transmitted through a variety of channels, and have identified six of the more important channels. We also know that these impacts might have a combination of complementary and competitive impacts. In general, actors in low income economies tend to see more opportunities and complementary synergies with the rise of the Asian Drivers. By contrast, observers in the high-income countries (particularly those focusing on low income economies) tend to be more aware of competitive impacts. And, finally we also know that these impacts may be direct and indirect. In general, most attention is placed on the direct impacts, since these are more visible through bilateral relations. But the indirect impacts may often be more important, and much more difficult to unravel.

These pockets of information are just that – pockets. There is an enormous and urgent task ahead of documenting these emerging impacts, distinguishing between different types of economies and regions, and different communities within these countries and regions. Unless these trends and subtleties are adequately understood, it will be very difficult for low income countries to maximise the opportunities and minimise the threats arising from the rise of the Asian Drivers.

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