

## China and India:

### A comparative analysis of their integration into the global economy

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#### **Abstract**

Global integration of China and India has had quite different effects on the structural pattern of their economic growth. Manufacturing became the engine of economic growth in the former whereas the latter thrived due to the rapid growth of services sector. The implications of their present patterns of growth seem to be very favourable for long-term development. However, employment effects of their integration into the global economy are quite similar, and are evident in fast growth of labour, migration of skilled labour force to developed countries, decline of employment in formal sector and slow growth of regular wage employment. In this context, sustainability of the fast economic growth of China and India depends largely on the extent to which they are able to generate a process for steady expansion of regular wage employment and productivity of low skilled labour force.

Key Words: economic growth, employment, labour, China, India

#### **Introduction**

Over the past two to three decades, China and India have attained spectacular prominence due to their rapid and sustained economic progress. The Chinese economy has been thriving at almost double-digit growth rates since 1980. Although the Indian economy did not grow as fast as China's, it has nevertheless been among the ten fastest growing economies in the world over each of the two decades, 1980-1990 and 1990-2000 (Izurieta and Singh, 2008, p.2). The unprecedented economic success is popularly attributed, largely, to the integration of these countries into the global economy (see Chow, 2007, p.9; Nolan, 2004, p.2; Mahtaney, 2007, p.14; Rodrik and Subramanian, 2004, p.1; Ahluwalia, 2002, p.87). Increasingly, the effects of their integration, particularly on economic growth and employment, are becoming an important terrain of academic inquiry. On this topic, a broad-brush review of the recent literature suggests that increased integration into the global economy has had quite different effects on economic growth in China and India. However, employment effects of the integration are quite similar for both countries. This review points out a paradox which calls for a cautious analysis of empirical facts in a comparative perspective.

In this context, I attempt to assess the above proposition empirically and discuss its implications. I begin by outlining an analytical framework which is generally applied to explain the empirical effects of increased integration into the global economy in light of the predictions of mainstream economic theory. The rationale for this framework derives from the need to identify some important dimensions of economic growth and employment that need to be taken into account in the analysis. Then, differences in effects of global integration on economic growth and similarities in employment outcomes are discussed in two separate sections. Obviously, the employment effects cannot be explained without a reference to the economic growth effects, and therefore, linkages will be drawn between the two sections. The last section summarizes key points of the analysis and draws conclusions.

Before proceeding further, it seems pertinent to delineate three important caveats. First, the statistical data on employment suffer from a number of important limitations (Ghose, 2008, p.47), and therefore do not allow a coherent comparison between China and India. Particularly, the data for same periods on a given set of variables are not readily available, but

an effort has been made to include statistics from a variety of sources to plug in the gaps in years as much as possible. Secondly, our discussion begins within a broad analytical context, but then gradually concentrates on two dimensions of economic growth (composition of Gross Domestic Product [GDP] and international trade, mainly exports) and two dimensions of employment (employment by sector and by type). Thirdly, it is presumed that the reader is familiar with key terms and categories related to economic growth and employment (such as formal and informal sector, regular wage employment, manufacturing, merchandise, etc.), as they are used in the literature on China and India. These categories are not defined here, except in such cases where a non-standard definition is used.

## **Analytical Framework**

What does economic theory tell us as far as the effects of increased integration on economic growth and employment are concerned? In order to answer this question, we need to first specify, what is meant by “integration”? In general, the term refers to liberalisation and openness of an economy in the corridors of market-driven globalisation (Kozul-Wright and Rayment, 2007, p.29). The term has been defined more concisely by Izurieta and Singh (2008, p.1) in the specific context of China and India as follows: China's and India's “integration is taking place under ‘current globalisation,’ which consists of free-trade, free capital movements and domestic labour market flexibility (instead of free international movement of labour)”. In this sense, the term “integration” is distinct from “globalisation”; the latter is an instrumentality for achieving the former (Mahtaney, 2007, p.197). This distinction guides our discussion in the remainder of the article.

Ghose, Majid and Ernst (2008, p.102) explain that at the domestic level, orthodox economic theory predicts that increased integration into the global economy creates the basic stimulus for structural change in the formal sector of the economy and defines the role of foreign capital. The motivation to increase exports brings comparative advantage in labour-intensive industries into play and fosters competition from imports thereby creating pressure for technological improvement in import-substitution industries. Moreover, free trade has a stimulating effect on output growth in developing countries through higher labour productivity by promoting specialization, encouraging the economies of scale, and facilitating technological innovations. As a result, employment growth in the formal sector takes place when labour-intensive industries expand faster than capital-intensive industries. Thus, employment per unit of output increases. However, when capital- and skill-intensive industries displace labour-intensive industries, employment growth in the formal sector is restrained, but accompanied by growth of productivity.

Ghose et al. (2008, pp.103-06) further elaborate that the employment effects of foreign capital and trade growth are largely confined to the formal sector, given that most tradable goods and services are produced in this sector. In the informal sector, neither capital inflow nor trade growth directly affects the output nor employment, as it largely produces goods and services for domestic consumption. Moreover, it does not receive inflows of foreign capital. However, export-orientation of a country necessitates a reallocation of investment from sectors producing non-tradable goods and services into sectors producing tradable goods and services.

At the global level, the analytical framework is derived from the standard trade theory. According to Ghose (2003, pp.43-45), the theory assumes that the advanced countries have

a higher proportion of skilled workers and therefore, have a potential comparative advantage in the production of skill-intensive manufactured goods. By contrast, the developing countries have a potential comparative advantage in the production of unskilled-labour-intensive manufactured goods. The theory predicts that free trade adversely affects employment conditions of unskilled labour in industrialized countries but benefits unskilled labour in developing countries. The opposite is true for skilled labour. The overall effects on employment depend on labour market regulations and institutions. If wages are difficult to change, total employment falls. It is important to note that such predictions are based on important assumptions, which may not correspond to realities. The comparative advantage of skilled-labour of advanced countries as predicted by the trade theory, for example, does not hold true for China and India due to increased outsourcing. This point will be further elaborated in the following sections.

### **Differences in effects of global integration on economic growth**

During the past two to three decades, China and India have attained extraordinary levels of economic progress by any standard. During 1980-90, China's and India's GDP grew at an average rate of 10.3 per cent and 5.7 per cent per year, respectively (Srinivasan, 2006, p.3716). During 2005-07, the average growth rates were even higher at 11.7 per cent for China and 9.6 per cent for India (World Bank, 2009). Although India's GDP growth has been lower than China, it is still remarkable as compared to its so-called 'Hindu growth rate' of 3.6 per cent per year between 1951-52 and 1980-81 (Acharya, 2004, p.4537). Indeed, as Srinivasan (2006, p.3716) has observed, China and India are the only countries in the world which have been able to sustain their rapid growth over two and a half decades since 1980, regardless of occasional fluctuations.

As indicated earlier, it is widely believed that the spectacular economic performance of China and India is a result, largely, of their market-oriented reforms that were geared towards integration into the global economy. Apparently, the integration is characterized by some common dimensions. For example, both countries have traversed the path to openness and liberalisation quite slowly, unlike most developing countries. This strategy is aptly described for China in terms of "crossing the river while feeling the rocks" (Deng in Chow, 2007, p.59) and in terms of "gradualism" for India (Ahluwalia, 2002, p.67). More importantly, GDP grew sharply in both countries as a result of their transition towards market economy. This phenomenon urges one to think that the integration may have similar effects on economic growth in China and India, but it may be misleading because the change in mere growth rates in similar (upward) direction hides many deeper and differential effects of the integration process. But what are those effects?

The answer to this question must be explored through the lens of broader context in which the integration process was initiated in both countries. Substantial initial differences are documented in a vast body of literature. In China, the transition from the planned economy to market economy began with the introduction of wide-ranging economic reforms in 1978. Unpopularity of the Cultural Revolution, greater realization of the shortcomings of the planned economy, inspiration from success of market-oriented economies in East Asian countries, and the urge in Chinese people for a change were the four main reasons that motivated the Community Party of China to move away from the centrally planned economy (Chow, 2007, p.46). The reforms led to the widespread introduction of contract system, wider enterprise autonomy, corporatization, and floatation of part of companies' equity on domestic and

international stock markets by 1990s. “Market forces, including market-driven prices and entrepreneurship gradually permeated the economy...[c]ontrols over foreign trade were relaxed slowly over the course of two decades, and given a final impetus by China finally joining the WTO at the end of 2001” (Nolan, 2004, p.2).

By contrast, India embarked on economic reforms in a systematic way only in 1991 in the wake of an exceptionally severe balance of payment crisis (Ahluwalia, 2002, p.67). However, a spate of analytical papers have confirmed that India had already begun to move away from the socialist economy to market-economy which caused the break in trend growth rate in 1980-81 (see, for example, Sinha and Tejani 2004; Rodrik and Subramanian 2004; Panagariya 2004; Virmani 2004; Kohli 2006). Two waves of reforms – first in the early 1980s and the second in 1991 - substantially changed fundamental structure of the Indian economy through elimination of quantitative controls on imports of industrial machinery, reduction in tariffs on imports of capital goods, modest tax system rationalization, reduction in number of industries subject to government licensing, increase in foreign direct investment, expansion of the role of private sector, dismantling of import controls, lowering of customs duties, flexible exchange rate, and foreign investment, and a restructuring of government’s role in the Indian economy.

Although India entered into the global economy after a decade than China, the literature treats the pre- and early 1980s as the pre-reform era and post-1991 as the post-reform era for both countries (see, for example, Nolan, 2004; Knight and Song, 2005; Ahluwalia, 2002). The reason is obvious, i.e. although the economic reforms began in early 1980s, it was not until early 1990s that the integration process deepened through more open economy with greater reliance on market forces, larger role for the private sector and foreign direct investment in China (Chow, 2007, p.58) and in India (Ahluwalia, 2002, p.67). I shall use these reference periods for our comparative analysis below.

Despite some similarities in the nature of reforms, China and India pursued quite divergent growth strategies from the very beginning, which led to different outputs as the integration proceeded. This is evident from sharp differences in the sectoral composition of GDP. The share of agriculture in GDP was not much different in China (36.1 per cent) and India (38.1 per cent) in the pre-reform period. The share reduced dramatically during 1990s in both countries, but more so in China. In 2005, agriculture constituted just 11.4 per cent of China's GDP, as compared to India's 19.6 per cent (Table 1). While industrialisation in the wake of increased integration led to reduction of agriculture’s share in GDP, effects have had been quite different on the shares of industry and services sectors.

**Table 1: Sectoral Composition of GDP of China and India (% of GDP)**

	China				India			
	1980	1990	1997	2005	1980	1990	1997	2005
Agriculture	36.1	26.8	17.1	11.4	38.1	33.0	24.5	19.6
Manufacturing	25.4	25.3	31.1	34.1	17.7	16.7	17.7	15.1
Other industries	08.2	08.6	13.8	14.3	03.2	n/a	05.0	04.3
Services	30.3	39.3	38.0	40.2	41.0	41.0	50.6	61.1

Sources: (1) China: Calculated by Ghose 2009, from World Bank's World Development Indicators database.  
 (2) India: Reserve Bank of India 2008; Panagriya 2008: 283.

When the reforms began, China was already substantially industrialized, as manufacturing and other industries together were 33.6 per cent of its GDP in 1980. China's manufacturing sector has grown steadily since 1980 along with other industries. By contrast, industry's share in India's GDP was just 20.9 per cent in 1980 and has not registered significant growth. In sharp contrast with manufacturing-led growth of China, India's growth is led by the services sector. Nevertheless, the share of services in China's GDP was also significant at 30.3 per cent in 1980, it increased to 40.2 per cent in 2005. By contrast, India's services sector expanded more than twice the growth of China's services sector during the same period.

If we examine this output structure in relation to key measures of integration, the differences become clearer. China's share of exports in GDP was 18 per cent in 1990, which jumped to 34 per cent in 2004. India's share of exports in GDP rose to 19 per cent from 7 per cent during the same period, indicating that India remains less export-oriented as compared to China. Conversely, India is less dependent on imports than China, measured as a percentage of GDP. The share of world merchandise exports has also risen in the post-reform period, much faster in China. Similarly, the share in world exports of commercial services has increased from 1.6 per cent in 1994 to 2.9 per cent in 2004 for China and from 0.6 per cent to 1.9 per cent for India during the same period (Table 2).

The increase in share of exports hides many differences in the effects of integration on comparative advantages of China and India in trade. The shares of agricultural products, merchandise and services in total exports steadily decreased whereas that of manufactures sharply increased in China between 1984 and 2005. The bulk (91.1 per cent) of total exports of China in 2005 comprised manufactures and other merchandise. The picture of India is quite different in the sense that the exports of both manufactures and services increased substantially in the post-reform period, but its manufactures exports were about a half of China's. On the other hand, its share of services exports was almost three times higher than that of China in 2005 (Table 3).

**Table 2: Measures of China's and India's Integration with World Economy (% of Total)**

	China			India		
	1983	1994	2004	1983	1994	2004
Share in GDP of exports of goods and services	n/a <sup>1</sup>	18.2	34	n/a	7.2	19
Share in GDP of imports of goods and services	n/a	16.2	31	n/a	9.2	23
Share in world merchandise exports	1.2	2.8	6.7	0.5	0.6	0.8
Share in world merchandise imports	1.1	2.6	6.1	0.7	0.6	1.1
Country share in world exports of commercial services	n/a	1.6	2.9	n/a	0.6	1.9
Country share in world imports of commercial services	n/a	1.5	3.4	n/a	0.8	2.0

Notes: (1) Data are not available; (2) Shares are for 1990.

Source: Srinivasan, 2006.

**Table 3: Export Structure of China and India by Sector (% of total exports)**

	Agriculture	Manufactures	Merchandise 1	Services
China				
1984	18.9	43.0	47.3	9.7
1990	14.7	65.4	26.0	8.6
1997	7.5	75.2	12.9	11.8
2005	3.4	83.7	7.4	8.9
India				
1983	16.8	31.0	30.2	21.9
1990	13.5	48.6	20.2	17.7
1993	13.2	51.8	18.4	16.6
2000	9.2	49.9	15.3	25.7
2005	6.3	42.2	17.8	33.7

Note: (1) Includes primary commodities and non-manufactured goods.

Source: Ghose, 2009.

What are the implications of the differential impact of increased integration on economic growth of China and India? Internationally, the economic growth of these two countries has taken the advanced countries by surprise because the former poses formidable competition in the manufacturing sector and the latter in the services sector. It is believed that China and India will have much larger impact on the composition of world trade than Japan and South Korea (Mahtaney, 2007, p.170). Nationally, the implications of the present patterns of growth in China and India seem to be quite favourable for long-term development, but serious concerns exist about the employment effects of their global integration.

### **Similarities in effects of global integration on employment**

Prior to the economic reforms in 1978, unemployment was not a problem in China because workers were guaranteed employment through direct allocation of jobs, administrative control of remuneration and strict restrictions on migration between rural and urban areas (Ghose, 2008, p.49). Thus, in effect, there was no labour market wherein demand and supply factors could interact to determine the employment conditions (Knight and Song, 2005, p.3). The state control on labour supply prevented open unemployment to emerge, but led to a gradual accumulation of surplus labour in production units in both urban and rural areas. As China's integration into the global economy progressed, the rigid labour policies were gradually dismantled giving way to contracted tenure, minimum wage laws, migration between urban and rural areas and privatisation of small and medium state-owned enterprises (SOEs) and shedding of workers from state enterprises (Ghose, 2004, pp.49-50). Knight and Song (2005, p.3) note that the emergence of private enterprises created greater flexibility, but China still does not have a free labour market. By contrast, a labour market existed in India at the onset of its first wave of economic reforms in the early 1980s. However, it has had been far from perfect due to rigid labour laws, which effectively convert labour from a variable to a fixed factor of production (Acharya, 2004, p.4538). Nevertheless, India's need to reform labour market in line with the liberalisation policies was lesser, as compared to China, as the allocation of the Indian labour force was not controlled by the state.

A major effect accompanied by the increased integration is the rise of unemployment as a key problem in both China and India. According to Ghose (2008, p.50), employment in China grew at a rate of one per cent per annum, but the rate of unemployment increased from less than one per cent in 1990 to 2.7 per cent in 2005. In urban areas, the rate of unemployment was higher, as it increased from 3.4 per cent in 1990 to 7.1 per cent in 2005. The growth of unemployment was due to a process of speedy reduction of the surplus labour that the state and collective enterprises in both urban and rural areas had accumulated in the pre-reform period. Both types of enterprises shed labour hugely, resulting in a loss of 66 million jobs between 1997 and 2005. Most of the shed skilled-workers moved either to new formal jobs in the emerging non-state enterprises, or to non-formal jobs in the growing Township and Village Enterprises (TVEs) and private enterprises and individual businesses (PEIB). However, many of the low-skilled urban workers failed to find new jobs which increased unemployment (Ghose, 2008, p.51).

India's unemployment problem is not as serious as in China up till now, but it poses a serious policy challenge in the near future. Ghose's (2004, p.5111) estimates indicate that the rate of unemployment in India was just 2.8 per cent in 2000, which would be taken to indicate full employment by the standards of advanced countries. This led him to conclude, "unemployment is clearly not a problem that deserves priority attention" (Ghose 2004, p.5112). But according to his latest estimates, the rate of unemployment in India increased to 4.5 per cent in 2004-05 (Ghose, 2009). This increase indicates that, even if unemployment were not a serious problem now, it is fast becoming a source of apprehension, which could best be explained by looking at the inter-sector shifts as follows.

The bulk of the labour force was in agriculture in both China and India in the early 1980s, more so in India (Table 4). Thus, surplus labour was potentially available to both countries for Lewis-type growth, surplus workers could be transferred from agriculture to industry. Since 1980, labour force has steadily decreased in agriculture, but substantial part of it has been absorbed by industry in China and to a lesser extent in India. This is because the manufacturing sector of China is more processing-oriented, and therefore is more labour-intensive as compared to that of India (Ghose and Matsumoto, 2002, in Ghose, 2003, p.50). However, overall, the share of industry and services in labour force has increased in both countries, as these sectors grew in the wake of increase in export-orientation led by the integration process.

**Table 4: Distribution of Labour Force of China and India by Sector (% of labour force)**

	Agriculture	Industry	Services
China			
1980	69	18	13
1990	60	21	19
2000	50	23	27
India			
1983	86.6	14.7	16.7
1987-88	64.9	17.1	18.0
1992-93	64.0	19.9	20.1
1990-2000	60.4	17.5	22.1

Source: Nagaraj, 2005.

The effects of inter-sector transfer of labour on employment are associated with the corresponding output growth of these sectors (Table 1). Its implications appear to be far more serious for India than China. Dasgupta and Singh (2005) argue that India defies the Kaldorian pattern of growth, as its economic growth is led by services. This is in sharp contrast to historical evidence which suggests that the engine of growth in a country with per capita income level of India has to be manufacturing, rather than services. The concern of Dasgupta and Singh (2005) is that this phenomenon is creating “jobless growth” in the organized manufacturing as well as the services sector when the Indian labour force is increasing at 2 per cent per annum. Although India’s relatively younger labour force promises greater demographic dividend (Rodrik and Subramanian in Acharya, 2004, p.4538), it also requires that more jobs will have to be created. Otherwise, most of the excess labour in agriculture will either remain in agriculture or will have to be absorbed by the low-productivity informal sector.

It is further argued that, because the growth of India's services sector is predominantly led by information technology (IT), it has limited value as far as employment is concerned. The IT sector employs less than one million people in a total labour force of 450 million. It cannot absorb much additional labour due to the unique nature of IT services which require only educated and skilled people who constitute a minor proportion of the total labour force. Only five per cent of India's relevant age group receives college education. Other services such as hoteling, transport, real estate, restaurants and community services could have absorbed unskilled labour, but evidence suggests that they did not register significant acceleration in growth in 1990s (Dasgupta and Singh, 2005). The concern about the employment challenge appears to be more relevant in the wake of recent financial crisis. The second major effect of increased integration lies in the distribution of employment by type. This effect is similar both in China and India. Self-employment has steadily decreased in both countries, more so in China as a result of increase in wage employment. But the bulk of labour freed from self-employment has been absorbed in the informal sector in both countries. In China, this sector largely comprises of TVEs and private PEIBs wherein 14.7 per cent of the total employees were working in 1990. This number has increased to 23.2 per cent in 2005, due largely to the decline in wage employment in the state enterprises. The emergence of non-state enterprises became a source of formal wage employment, but their potential to absorb the labour relieved from the state enterprises has been limited so far (Table 4 and Table 5).

**Table 5: Distribution of Employment by Type in China (% of total employment)**

	1990	1997	2005
Self-employment	51.2	46.1	39.5
Informal wage employment			
TVEs	11.2	14.3	19.0
PEIB	03.5	09.8	14.2
Formal wage employment			
State	21.5	19.5	09.3
Non-state	0.2	1.5	5.1

Source: Ghose 2008.

The changes are similar in India. While the decrease in self-employment is fairly low, the share of employment in the formal sector has fallen substantially since 1983 (Table 6). A

major reason is that India's labour force is still largely low-skilled and therefore, is largely employed in the informal sector (Ghose, 2004, p.5108). Moreover, fewer new workers were employed by the formal sector as the technological improvements and transition towards the economies of scale as a result of pressure from trade-openness increased labour productivity significantly in both China and India (Ghose et al., 2008, pp.104-06).

**Table 6: Distribution of Employment by Type in India (% of total employment)**

	1983	1993-94	2004-05
Self-employment	57.3	56.4	56.6
Causal wage employment	28.9	31.8	28.4
Regular wage employment	13.8	13.6	15.2
Formal sector employment	7.9	7.3	5.8

Source: Ghose, 2009.

A major implication of the low capacity of formal sector to absorb high-skilled labour is the increase in “brain drain” in China and India. The data compiled by Ghose (2008, pp.54-55) show that a huge proportion of the skilled labour force is migrating to developed countries. In 2000, the number of skilled migrants was about 0.8 million each in China and India. The number of high-skilled migrants (0.4 million in China and 0.5 million in India) was much higher than the low- and medium-skilled migrants.

Globally, entry of China and India into the global economy has come to be seen as a major threat in advanced countries. The pioneering work in this regard has been done by Richard Freeman (2005) who argues that in the past, the advanced countries' trade with these two economies may not have harmed the workers in the former but the situation has now changed. The entry of China, India and the former Soviet Bloc countries into the global economy has doubled the globalized labour force. In 2000, the globalized labour force comprised of 1.5 billion workers, but has swelled to nearly 3 billion after their integration. Freeman argues that the success of China in manufacturing and India in services may ultimately affect 10 per cent of the United States' labour force.

Izurieta and Singh (2008) make a case against Freeman (2005) by arguing that, overall, the integration of China and India into the global economy is likely to be more complementary, rather than competitive, with that of the United States and other advanced countries. The fast growth of these two economies is beneficial for the whole world, as it is essential to meet the employment needs and provide basic necessities to their huge population. Moreover, the growth in these two countries has spurred demand for raw materials and commodities from other countries, which is ultimately helping them also to grow faster

## **Conclusion**

Empirical evidence suggests that the increased integration of China and India into global economy has had quite different effects on economic growth, but somewhat similar effects on employment. In respect of economic growth, the effects are conspicuously different in output structure, i.e. the engine of growth in China is manufacturing sector whereas in India, the growth is led by the services sector. Accordingly, the composition of their

international trade is strikingly different; the largest share of China's exports comprises of manufactures, whereas in India, both manufactures and services constitute major proportion of the exports but the latter's share is increasing rapidly. By contrast, employment effects are quite similar, and are evident in the rise of unemployment problem, decline of employment in the formal sector, and slow growth of regular wage employment. There is a need to generate a steady process in both China and India that leads to the growth of regular wage employment which exceeds the rate of labour force growth.

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