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Rural Industrialization in China and India: Role of Policies and Institutions

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Summary. — The dynamic rural nonfarm sector in China has been a major contributor to the country's remarkable growth, while in India the growth in output and employment in this sector has been rather stagnant. This paper argues that the observed patterns in the rural nonfarm development are the results of institutional differences between the two countries, especially in their political systems, ownership structure, and credit institutions. A review of the strengths and weaknesses of the rural nonfarm economy in China and India highlights the potentials and challenges of growth in the sector.

Key words — China, India, nonfarm economy, industrialization, growth, inequality

1. INTRODUCTION

Over the last five decades, China and India have made dramatic improvements in their standard of living and structural transformation of the economy. Agricultural growth has made both countries self-sufficient in food, providing a residual surplus for export and capital for other sectors. Industries and services now form an integral part of the output and employment of the rural sector. The share of agriculture in total GDP has declined to less than one-third in India and about one-seventh in China. This transition is remarkable considering the initial situation in the two countries half a century ago.

However, a look behind the macro-economic aggregates reveals more rapid growth of rural nonfarm employment in China than in India, especially over the decade of the 1990s (Figures 1 and 2). [1] This paper aims to address the following questions: why has the development of the rural nonfarm sector followed different paths in China and India over the past two decades? How much of the current growth or stagnation are the results of institutional differences between the two countries, especially in their political systems, ownership structure, and credit institutions? What lessons can be learned from the relative strengths and weaknesses of the rural nonfarm sector in the two countries? In a similar vein, Lal (1995) compares the economic liberalization in China and India up to 1990. However, because most of India's liberalization policies did not fully start until the early 1990s, it is necessary to extend his comparison to a later period with a particular focus on the rural nonfarm sector.

After China and India's entry into the World Trade Organization (WTO), they are having increasingly important impact on the world economy given their rapid growth and size. [2] With globalization, there is greater capital flow to the two countries to take advantage of their cheap and abundant labor force, thereby stimulating the growth of their nonfarm sector. Rapidly industrialized China and India will

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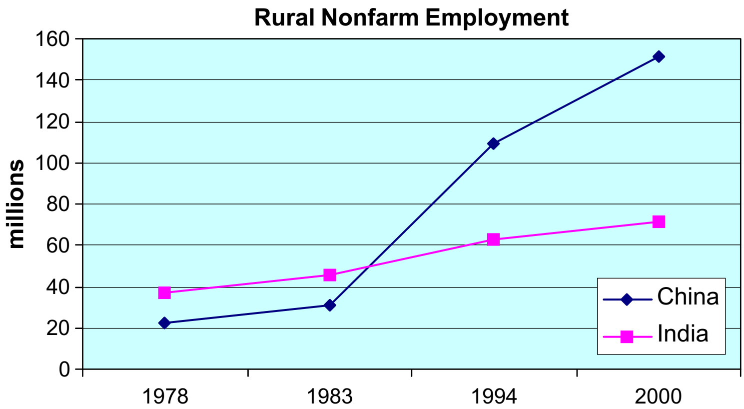

Figure 1. *Rural nonfarm employment, 1978–2000. Source: India—National Sample Survey Organization, various years; China—Fan et al. (2003).*

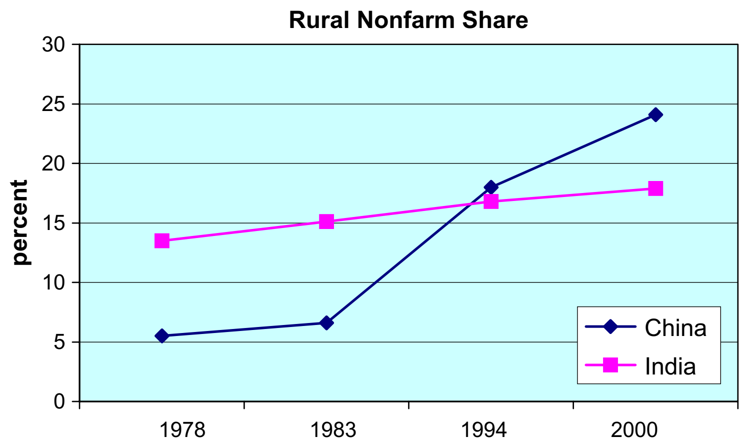

Figure 2. *Rural nonfarm share in total employment, 1978–2000. Source: India—National Sample Survey Organization, various years; China—Fan et al. (2003).*

affect production patterns, trade flows, financial flows, environmental spillovers, and global and regional governance (IDS Asian Drivers Team, 2006). An examination of the causes, potentials, strengths, and weaknesses in China and India should, therefore, provide useful indications for other developing countries in the process of nurturing a viable rural nonfarm sector in the current global context.

2. POLICY FRAMEWORK FOR NONFARM DEVELOPMENT

In this section, we first present the patterns of rural nonfarm sector development and then look at the path of policy-making since the beginning of the 1950s in India and China. In the 1950s, both countries were largely agricultural societies. For China, the nonfarm sector took off only after the rapid growth in the agricultural sector from 1978 to 1984 and the shift to the *Household Responsibility System*. When China started the rural reform in 1978, the share of rural nonfarm employment in total employment was slightly over 5%, less than half of the level in India (Figures 1 and 2). By 2000, China's rural nonfarm employment doubled that of India's. The number of workers in the manufacturing sector increased from 14 million to 22 million from 1977/78 to 1999/2000 in India while it shot