

The Economy in Perspective

by Mark Sniderman

Democracy is good. I say this because other systems are worse.
—Jawaharlal Nehru, Prime Minister of India
(January 1961)

If you look at the 150 years of modern China's history since the Opium Wars, then you can't avoid the conclusion that the last 15 years are the best 15 years in China's modern history.
—J. Stapleton Roy, U.S. ambassador to China,
in the *New York Times* (September 1, 1994)

I didn't think very much about China or India when I was growing up. I knew they were there, of course, on the other side of the globe—large countries with very large populations. I supposed that the people who lived there were poor and tied to the land. India entered my teenage consciousness more tangibly when the Beatles went to commune with the Maharishi Mayesh Yogi, but the country was, to me, still just a large and exotic place. China, what I thought of as the wellspring of the egg roll, appeared as a slightly larger blip on my radar screen when the Vietnam conflict became the Vietnam War.

Relative to the United States, China and India are still poor countries with large populations whose livelihoods depend significantly on the land. But these countries—individually and collectively with other countries in Southeast Asia—are remarkably transforming themselves and the global economic order. Today's young Americans probably will have far different childhood recollections of China and India than I did, and, unless the economic transformations now underway are unexpectedly cut short, that pattern should continue for several generations.

To put the pace of change in perspective, consider this mathematical example by Stanley Fischer, Governor of the Bank of Israel.¹ Fischer notes that the Chinese economy has been growing in real terms at rates in excess of 10 percent per year for over 25 years. Fischer conjectures that if the U.S. economy grows at its long-term average of about 3 percent per year, China's economy will equal the size of the U.S. economy in roughly 25 years. The Indian economy has been expanding a bit more slowly than the Chinese economy—8 percent per year—and would take somewhat longer to match the size of the U.S. economy.

Certainly it will take more time for the typical Chinese or Indian resident to enjoy the same level of per capita income as the typical U.S. resident, for the populations of China and India are considerably

larger than that of the United States. But the trends are unmistakable: According to calculations cited by Fischer, if China and India continue on their current development paths, they, together with the other developing Asian countries, could account for half of the world's GDP in 2030, up from just a bit more than one-third today.

Whether or not these countries can stay on their vigorous growth paths remains to be seen. When people speculate about the bright futures of the Chinese and Indian economies, they often stake their claims on the belief that these nations are doing a superior job in educating their populations: China and India are well-known for turning out very well trained college graduates in science and engineering fields, and they have been able to achieve enrollment rates in their primary education systems of more than 95 percent. But secondary education enrollment lags far behind in both countries, and education generally within the adult populations remains a drawback to better economic performance.

Education is not the only challenge facing developing economies. Cross-country comparisons of economic growth strongly conclude that rapid growth depends not only on the quality of human capital, but also on the competitive structure of markets. In an interesting study of Latin America's subpar economic performance during the past 50 years, the authors conclude that Latin American economies suffered from high costs of starting a business, poorly functioning capital markets, and high costs of adjusting the workforce or building up an experienced workforce.² Their problems stemmed not from having poorly educated workforces, but from excessive government intrusion into the operation of the economies in the region. The experiences of these nations suggest that China, India, and the other emerging Asian nations will also have to keep transitioning to more competitive markets if they hope to expand per capita income growth. These transitions can often present difficult internal challenges.

In the same way that I had a vaguely defined conception of China and India in my youth, I now realize that I had only a hazy grasp of my own country. Most of all, as I look back, I'm struck by how immutable the world seemed then. Things were the way they were, and seemingly would always be so. Such are the follies of youth.

¹Stanley Fischer. 2006. "The New Economic Global Geography," speech delivered at the 2006 Federal Reserve Bank of Kansas City Economic Symposium at Jackson Hole, Wyoming.

²Harold L. Cole, Lee E. Ohanian, Alvaro Riascos, and James A. Schmitz Jr. 2006. "Latin America in the Rearview Mirror," Federal Reserve Bank of Minneapolis, *Quarterly Review*, September.