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Inflation and Growth Rates in India and China: A Perspective of Transition Economies

S. Madhukar
Research Scholar, Department of Economics, University of Hyderabad, Gachibowli, Hyderabad, Andhra Pradesh, India. Pin 500046.
E-mail: madhukarsidam@gmail.com

Dr. Boppan. Nagarjuna
Faculty in Department of Economics,
University of Hyderabad, Gachibowlly, Hyderabad, Andhra Pradesh, India. Pin 500046.
E-mail: bnss@uohtd.ernet.in

Abstract—**Stabilization is a vital component of transition. Transition economics is a change from a centrally planned economy to free market. In 21st century, India and China are the world's fastest growing economic countries. This paper compares transition economic relationship in terms of inflation and growth in India and China. Data has drawn from IMF. Macroeconomic parameters clearly confirm that both Chinese and Indian economies are against inflationary capacity constraints. After transition, inflation does affect on growth rates in a long run in both countries since 1979 to 2009. As a result, both countries have growth and inflation rates negative correlation. However, we can also see much higher fiscal deficits are associated with higher inflation its result lower growth.**

Keywords: Transition Economics; China; India; ***Inflation; and Growth rate.***

"Perhaps the most useful criterion for assessing success in the transition is the sustainable recovery of output, which can be achieved only by controlling inflation and liberalizing markets".

…….. Oleh Havrylyshyn and Thomas Wolf

I. Introduction

Stabilization is a vital component of transition. Since the fall of the Berlin Wall on 9 November 1989, a majority group of economists has been studying the process of transition from socialism to capitalism in former socialist economies. It is called as 'transition economics or transformation economics'.[1] During the year of 1950, two countries jointly proposed the doctrine of Panchasheel *(Five principles)* in the year 1954 for resolution of border disputes and regional stabilities. The year 2010 marks sixty years of diplomatic ties between two biggest economies.

The year is an important milestone in their economic relations with bilateral trade. In 21st century, both countries are fastest-growing economies in the world. Both countries have similar factors. Moreover, both countries wish to move up the value chain in their next stages of development. Both countries have a one-third of the world's population also facing the related problems such as unemployment, environmental degradation, poverty and non- performing loans, an institutional frailties and structural problems. However, inflation and growth rates are an important indicators that influences economy.

Across the transition economies, extensively determined stabilization is vital in improving the economic performance. Still relationship between inflation and growth remain controversial in theory and empirical (Hossain and Chowdhary 1996, Girijsankar Mallik, Anis Chowdhary, 2001). Stabilization means reduces the inflation, domestic and external imbalances. This policy is important for transition because macroeconomic imbalance denies countries the gains of market reforms. The price stabilization always follows liberalization as a basis for growth.[2] Both countries are different but struggling with inflation. Such constrains are an affects of inflation via its affect on demand and its interrelation with the supply side of the economy. Although, macroeconomic determinants of the supply side and its affect on inflation and their relative growth rates. In any country, maximum inflation rate has high recorded at the beginning of the transition process, due to prices and trade control. We can also see, a higher fiscal deficit was associated with higher inflation and it results in lower growth.[3] After transition, big bang approach; results in an unexpected sharp and prolonged decline in GDP with high inflation rates and serious deterioration of other social

[1]. Seen in, Gerard Roland (2004), "Transition and Economic, Politics, Market, and Firms", MIT publication, London, March.

[2]. As shown below, some transition countries have liberalized faster than others have, but none has registered sustained growth without containing inflation at moderate levels.

[3]. See Fescher, Stanley, Sahay, Ratna and Vegh, Carlos (1996), "Stabilization and Growth in Transition Economies: The Early Experience", International Monetary Fund, April, p. 11.

indicators (World Bank 1996; 2002, Justin Yifu Lin, 2004). Moreover, too much GDP also dangerous, as it will not likely come up with increase inflation. The majority economists today agree that a small amount of inflation is more beneficial than more detrimental to the economy (Gamze Sevin, Melis ELCi, Asli Uncu and Gozde Timincioglu). Even number of studies had done on cross-countries it shows inverse relationship, according to (Carlos G. Fernandez Valdovinos, 2003) found that the average long-tern rate of inflation in a country is negative associate with the country long run of growth rates.

However, structural reforms and initial conditions influence the inflationary process during the transition. This paper emphasizes on the cross-country analysis after transition economic, inflation affect on growth rates in long-term both countries since 1979 to 2009. To compare macroeconomic factors like a GDP growth annul and Inflation consumer price (CPI), data has been drawn from IMF *'International Financial Statistics'* to analyze theoretically. Base period was (2005=100).

II. Empirical Analysis

The (figure 1, 2) is clearly illustrating about, an overall inflation and growths in both counties have been moderate since the reform, particularly in comparison with other transitional economies.

However, in first figure, China has been troubled by persistent 'boom-bust' cycles, in which periods of unsustainable rapid, inflationary growth have followed by period's macroeconomic austerity and slow growth. Since an initial period of transition in China, overall average growth rate is 10 percent increasing in per year. Despite of the fact that China's economic growth was accelerating virtually overall years, China underwent an inflationary crisis during 1988-1989 that shook of the foundation of its political and economic system. Later on, both aspects have simultaneously improved healthily. In 1993, interestingly both aspects were equal. Evident in year of 1978, 1984-1985, 1992-1995 and 2005-2007 crowning levels of growth rate. In 1993-95, inflation rate at surge has occurred its very less dire consequences, China policy makers declared their intention to achieve a 'soft landing'. By the end of 1997, a soft landing had achieved, inflation brought down very low nearly four years. During the periods of 1998, 1999, 2002 and 2009 inflation were negative rates, and in 1994, inflation rate was double digit 24.2 per cent this was highest rate in 32 years. In 1998 to 2002, inflation fell into deflation due to consumer price declined nearly 26 months. Especially world crises in 2009, growth rate was moderate, but inflation rate was negative. However, in growth rates were influences to the inflation. Every high growth period serious strains on the economy, include inflation and sectoral bottlenecks, long–term growth is clearly a good thing, but it does not follow that maximum growth in a short time period is always desirable (*Barry Naughton, 2006*). However, inflation and growth rates were a remaining period shows healthy performances. The stabilizations succeed only if growth follows. If it does not follow the stabilization policies governments may find it impossible to sustain the stabilization.

In figure-2, is explaining about that India's growth rate has not risen at even two-digit level in three decades, overall average growth rate is 6 per cent per year. India economy is calculating inflation with the Wholesale Price Index (WPI).[4] In 1980s, inflation was 11per cent and 10.9 per cent in 2009 respectively. During the period 1980s, India economy was being initiated by the reforms. In 1979, the growth rate was negative -5.24 per cent at the same time inflation was 15.75 per cent before reforms, and this was overall highest in 32 years. After transition, GDP growth rate had grown rapidly except in 1991. At the same time, inflation rate has doubled. Because of the financial reform and fiscal deficit took place in 1991, adverse effect on growth rate was very less 1.1 per cent. The transition effect on economy up to five years inflation rates had increased. Since 2002, almost equal of inflation and growth rates due to increase in oil prices twice during the period and adverse impact of drought on agri-products leading to increase in prices-especially oilseeds and edible oils. Inflation in India, caused for increase in international oil price and natural disaster like drought or flood, is showing gradual fluctuating trend. However, the year 2009 global financial crisis in Indian growth rate 7.7 per cent significantly become slow. Finally, inflation and growth was smooth. However, inflation is influences to the growth. Thus, the both countries growth and inflation were negative correlations. In China, growth influence inflation meanwhile in India, it was reversed inflation effects on growth. The first half of the financial year 2008-09 was marked by high WPI based inflation, primarily due to the rise in global commodity and fuel prices. The sequent global economics meltdown starting in September 2008 reversed the trend and inflation slipped into negative region during June to August 2009. Because of the declined in commodity prices globally land the base affect. As regards to food inflation, the upswing noticed in the first quarter of 2008-09, continued during 2009-10 to due to unfavorable south-west monsoon, the worst since 1972 (*Economic Survey of India*).

World economic growth and inflation rates have been fluctuating. Now, inflation rates have been dominating to compare with growth rates in virtually years. Although, growth rates were not increased at least 5 per cent above in three decades. In 2009 global financial crisis, it adversely affected on whole the world. A comparison of the food index published by the World Bank and WPI based domestic food inflation reveals that since April 2008 World food price reflected much higher volatility compared to the WPI food index. Further, high validity had seen in the international market in almost all commodity groups

[4]. It is different from the rest of the world. Each week, Indian Government is calculate inflation by wholesale price of a set of 435 goods is by the. Since these are wholesale prices, the actual prices paid by consumers are far higher (RBI).

compared to the domestic market in India (*Economic Survey of India*, *2010).*

III. Conclusion

This study attempts on cross-country compare the both countries inflation and growth rate. In 21st century, both countries have been fastest growing economically as well as growth rates. India and China will maintain high growth rates and Asia will continue to lead the global recovery in world. However, it faces challenges from inflation and excessive capital flows (*IMF offices*). Macroeconomic parameters clearly confirm that both the Chinese and Indian economies are against inflationary capacity constraints. In this analysis, inflation impacts on growth rate meanwhile in India it was inverse relationship. Both counties growth rates and inflation was negative correlatives. Since transition, China's growth rate has been accelerating, while India has not reached at least double-digit growth in whole years. Even, China inflation rate was more fluctuation than India. However, India reforms have taken place in one decade even though still it would compete with China. Hence, China overall performance has very remarkable, but transition in China is not complete yet. Still, several reforms and other policies are logging behind in the economics system in become internal inconsistent (Justin Yifu Lin, 2004) while India, still transition has to develop more. After transition economic, question rises, does inflation can affect on growth rates in both countries? Thus, both countries have different impact on growth and inflation.

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Appendix -1

Figure 1: Compare the Inflation and GDP of China Since 1978 to 2009

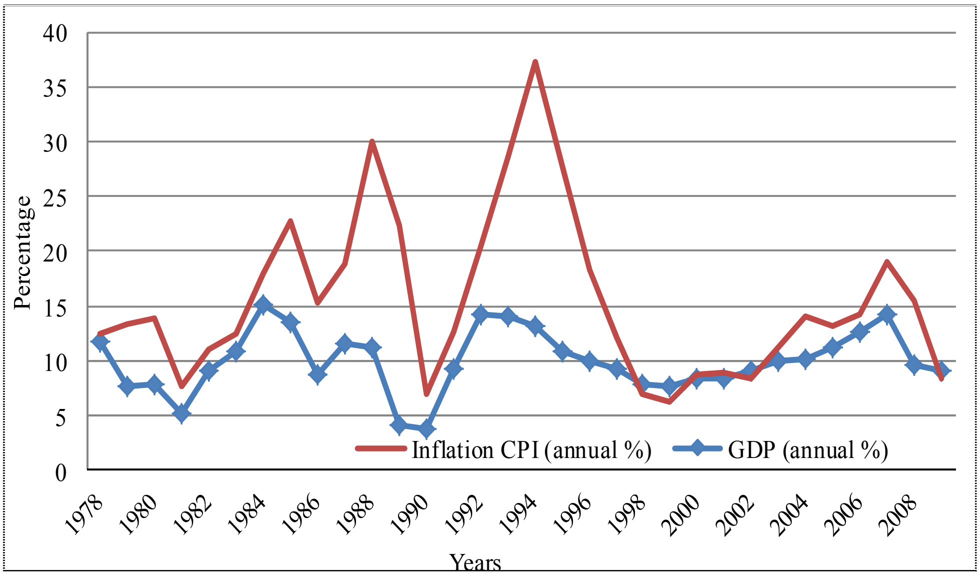
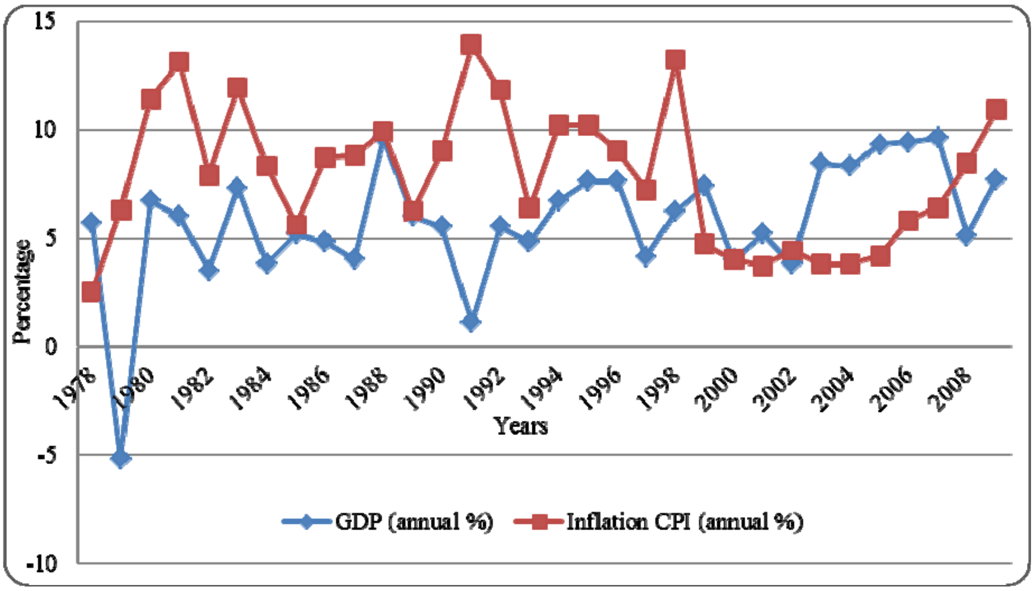


Figure 2: Compare the GDP and Inflation of India Since 1978 to 2009



Sources: International Monetary Fund, October 2010.