PR China and India – Development after the Asian Economic Crisis in a 21st Century Global Economy

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Berichte aus dem Weltwirtschaftlichen Colloquium
der Universität Bremen

Nr. 69

Hrsg. von
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Berichte aus dem Weltwirtschaftlichen Colloquium
der Universität Bremen, Nr. 69, Januar 2001.
ISSN 0948-3829

Bezug: IWIM – Institut für Weltwirtschaft
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Abbreviations

ADB	Asian Development Bank
ARF	ASEAN Regional Forum
ASEAN	Association of South-East Asian Nations
BfAI	Bundesstelle für Außenhandelsinformationen
BJP	Bharatiya Janata Party
CAC	Capital Account Convertibility
CP	Communist Party (of China)
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IT	Information Technology
IMF	International Monetary Fund
LDC	Least Developed Country
PR	Peoples Republic (of China)
SAP	Structural Adjustment Program
SAARC	South Asian Association of Regional Cooperation
TNC	Transnational Corporation
UNO	United Nations Organization
USSR	Union of Soviet Socialistic Republics
WTO	World Trade Organization

PR China and India – Development after the Asian Economic Crisis in a 21st Century Global Economy[1]

ACHIM GUTOWSKI[2]

Abstract

With the slow step-by-step economic liberalization of the countries PR CHINA and INDIA during the last three decades we can monitor a historical process including the integration of almost half of the worlds' population into the global economy.

Despite some similarities between PR China and India the process of transformation of these economies is quite different. There are gaps in the liberalization of foreign trade and attracting foreign direct investment and therefore in the integration in international capital flows and international division of labour. Dome of those gaps are being analyzed and an overview is given about the transformation- and liberalization process in PR China and India. Selected important aspects of a rising integration into the world economy of India and China are discussed.

Furthermore, the facts and degree of involvement and integration of India and PR China in the so called *Asian economic and financial crisis* are analyzed. As regards the world trade, India has a minor role with less than 0,5% (1998). This could be one reason why India has not been affected to a large extend by the crisis.

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1 PAPER PRESENTED AT THE INTERNATIONAL CONFERENCE „The New Trends after the Asian Economic Crisis and the Evolutionary Economics", AICHI UNIVERSITY, TOYOHASHI/JAPAN, SEPTEMBER 2000.

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However, PR China has been able to increase the percentage of world trade in the last two decades to about 3%; a remarkable development of foreign trade. This seems to be one of the reasons why China got more affected by the Asian crisis than India was. Financial sector reforms and the integration into international capital flows play another vital role.

Finally, an overview is given regarding the bilateral political and economic ties between PR China and India. Some of the facts influencing those relations are described, which also seem to affect the Asian region as a whole. It is important to realize that economic and political relations between PR China and India cannot be divided; they strongly interrelate each other.

1 Introduction

With the increasing globalization of world markets the world economy is in the stage of a large turnaround. New regions and new countries, which – until now – hardly participated in the world trade force themselves into the international divison of labour and strive to benefit from it. Countries in South-East Asia integrated themselves in the world economy.

With the slow step-by-step economic opening of the countries PR CHINA and INDIA during the last three decades we can monitor a historical process including the integration of almost half of the worlds' population into the global economy.

Despite some similarities between PR China and India the process of transformation of these economies is quite different. There are gaps in the liberalization of foreign trade and therefore also in the integration in the international division of labour.

As regards the world trade, India has a minor role with less than 0,5% (Bundesstelle für Außenhandelsinformationen, 1998, p. 6). However China has been able to increase the percentage of world trade in the last two decades to about 3%; a remarkable development of foreign trade. This is one of the reasons why China got more affected by the so called „*Asian Financial and Economic Crisis*“ than India was. Important in this relation is the fact that the increasing foreign trade of PR China focused more and more on Asian neighbour countries. While in 1980 only about 50% of PR China's foreign trade was conducted with Asian countries, this figure increased in 1995 already to about 62%. Therefore it is surprising that India as a trading partner almost remained unimportant. The bilateral trade figures between India and PR China hardly reached 1 billion US-$.

However, according to mid- and long term prognosis an impressive dynamic and sustainable development of PR China and India will be generated in the following decades of the 21st century.

Whereas the industrial nations only can count with an average increase of their gross domestic product (GDP) of 2,7% p.a. in the next 25 years, for CHINA annual growth rates of 7,6% are forecasted (Institute of Developing Economies, 1995, p. 2); other sources state growth rates between 6,4% and 8,8% (Deutsche Bank Research, 2000, p. 67). China is still on its way on a strong economic growth path with a real increase of GDP of 11,7% with the years 1991 to 1995 (Bundesstelle für Außenhandelsinformationen, 1997, p. 2). Since 1985 it increased its exports tenfold. According to the World Trade Organization (WTO) China for the first time was number ten in world wide trade in 1997 – with a rise in exports of a fascinating 21% in 1996/1997 (People's Daily Overseas Edition, 1998, p. 1). Sources predict that in 2020, China will belong to the five largest global economies. At that time, a huge middle class society with about 700 to 800 million households will be developed in Asia which will outnumber the markets in the European Union (EU) and the USA together (Weggel, 1997, p. 226). China's population of about 1,3 billion people should develop itself to become one of the world's largest and main producer as well as consumer of goods and services. In 2020 the country should have overtaken the USA in that matter.

The purchase power of many segments due to higher income of the society should develop progressively (Walker, 1997, p. 6).

At the same time, INDIA is a remarkably prospering country; the huge continent is one of the three fastest growing Asian economies. In 2001, it could become the fastest. The Asian Development Bank (ADB) predicts 7% economic growth rate for India in 2000 and 2001; other sources state a growth of GDP of 6,1% in 2000 and 7,2% for 2001 (Deutsche Bank Research, 2000, p. 67). In 2000 India would be overtaken by South Korea, which is expected to reach 7,5%. But in 2001, South Korea's growth will slump to 6% (the same as China's) and India will forge ahead (Outlook India, 2000, p. 1). The decade of development will be led by the new economy and boom in services helped along by industrial and infrastructural recovery. Statements of well-known economists seem to prove the prognosticated thesis: „*We concur that India has a chance for a tremendous breakthrough in economic development this decade*" (Sachs, 2000, p. 2); „ *I believe India is a country of the future. With accelerated reforms an 8-10% growth is possible*" (Kohler, 2000, p. 1). Other sources report the „continuation of an across-the-board" resurgence of positive factors. In 1999-2000 industry grew by 8%. More important in April 2000, the first month of the current Indian fiscal year, the index of industrial production was 12,2%; manufacturing industries grew by 14% – a record in recent years (Outlook India, 2000, p. 2).

On this background, we must focus our attention on the important question of analyzing the different steps of India and PR China related to the liberalization of foreign trade and the integration into a 21st century global economy. Another important factor is the analyzation of the bilateral political relations which also strongly influence the economic relations between the two countries and the facts which affect those not always harmonic ties.

2 The Process of Transformation and Liberalization in India and PR China

India and PR China are „core countries“ in Asia as regards several facts. With a population of together about 2,3 billion people which is about 40-50% of the world’s population (Far Eastern Economic Review, 2000, p. 4), the countries are most important regions of economic growth in Asia and furthermore world wide; the importance for the world economy and world trade will increase rapidly in the future. In some decades, they will be listed as some of the largest economies world wide. Some of the future potentials are named to be the low wages (low-wage-countries), the large potential of human labour, a large variety of natural resources and – due to the large population and the dimension of the countries – to belong to one of the most attractive global markets.

The two countries have in common that they are in a process of transformation and liberalization and in a phase of shifting from former „planned economies“ to more „market related economies“. India and PR China have been more or less „closed economies“ for a long time which were not open and related to world markets, having a high degree of protectionism. The former objective was to be political and economical independent which nowadays fades away with the slow step-by-step opening to world markets.

The reforms were related with a large degree to economic prosperity and economic growth rates. Especially in PR China rates of Gross Domestic Product (GDP) increased heavily over the years; 1991-1995 approx. 11,7% p.a. (Bundesstelle für Außenhandels-informationen, 1997, p. 2 f.). But still, the two countries face problems as regards the infrastructure, social tensions, labour markets as well as a rising pollution of the environment related to a strong progressive industrialization strategy. Moreover, the countries face the danger of political instability being closely related to the success of the transformation process and the achieved economic growth rates.

Despite the common facts and interrelations of the two countries, India and PR China also face large differences and success in the realization of the reform processes as well as their achieved and future importance for the world economy. Therefore, future prospects in terms of the integration into the international division of labour and general the globalization aspects are viewed and commented very differently.

2.1 Development of Reforms in India

In India, first discussions about the need of „policy changes“ arose in the early 1960s with the development of the third five year plan (1961-1966). Problems and challenges were discussed as the role of the goverment towards economic management, the relation of the public and private sector, the attraction of foreign direct investment (FDI) and foreign technology as well as problems of economic concentration (Hauff v., Haan De, Kruse, 1994, p. 18). But only at the end of the 1970s some of the large deficits became clearer, so that the internal politics – mainly the industrial politics – got more and more evaluated and criticized. The central industrial politics' objectives have not been reachable. One aspect to be mentioned is the fact that the secondary sector grew too slow. Second, the mismanagement and inefficieny of state-owned companies increased and related to that their dependence on subsidies rose.

At that time first thoughts of conducting main reform programs came up, which started 1978, were followed 1980 with Indira Gandhi and later followed-up extensively by Rajiv Gandhi (Singer, Sumit, 1993, p. 143). With Rajiv Gandhi main deep structural changes in the economy started with the long term objective of increasing economic efficiency, allowing more competition and a step-by-step deregulation of the economy. The reason was the missing foreign trade exchange with the former USSR and other Eastern European countries. Before that time, about 30% of the Indian foreign trade occured with the USSR and related Eastern countries in exchange to „soft currency“; also important goods as oil and military products were traded (Wieck, 1999, p. 58). India was able to sell its goods which were not competitive on world markets. But just before the division and break-down of the USSR into single independent countries and regions the government of the USSR decided in 1991 to exchange products in „hard currency". Following that, India suddenly had huge problems with its little reserves in foreign currency and got into a crisis and debt problems as regards its payments.

As regards inflation a more or less stable development can be observed over the years (see Table 1). However, an increasing trend is prognosticated for 2001 and beyond due to rising prices of agrar products because of dependence on the climate. To date industrial activity has not affected inflation, with industrial utilisation levels still not having reached their full capacity. Internal inflationary risks would arise if the government decided to monetize part of its budget deficit. This has not been the case so far, with the majority of the deficit coming from market borrowing. However, with domestic demand expected to increase and rising oil imports, inflationary tendencies should feed through the first quarter of fiscal year 2000/01.

Table 1: Development of Rate of Inflation in India, 1990/91 to 2001/02

	Rate of Inflation [%]
1990/91	12,1
1991/92	13,6
1992/93	7,0
1993/94	10,8
1994/95	10,4
1995/96	4,4
1996/97	6,9
1997/98	5,3
1998/99	4,6
1999/00	5,0
2000/01*	2,3
2001/02*	5,8

*: prognosticated

Source: Deutsche Bank Research, 2000, Country Brief Asia, p. 23; Center of Monitoring Indian Economy, 1999, Economic Survey 1998/99, p. 64; own calculations.

The process of the liberalization- and reform process was mainly influenced by the development of the mentioned debt situation of India. Increasing debt problems led to the Structural Adjustment Program (SAP) of the World Bank, which introduced – together with the new elected govenment under Prime Minister Rao – a totally new process of transformation and an immense political and economical change of structures in 1991. On the background of an over forty years old planning system including many state-owned companies, the liberalization and reform process can considered to be as a revolutionary process. Lately, the process lost its vitality, prosperity and sustainability, but it seems that it is not reversible.

As regards foreign trade, foreign investment and foreign relations, the objective was to liberalize and open up the Indian economy with its various markets, integrating the country into the world economy. The substitution of imports should slowly be decreasing and the export sector strengthened. One main measure was to allow business of foreign companies without long bureaucratic procedures and major foreign stakes (51%) in selected industrial and trade sectors. The convertability of the Indian Rupee in important sectors was allowed in order to consolidate the finance situation.

In 2000, India is still on the way to transform itself from a „mixed economy“ to a „market economy“. However, the reforms get along with different political and ideological opinions and views on the quality of the general way and are combined with the resistance of groups in the private entrepreneurship. Resistance and barriers result from potential loosers and several interest groups from politics, the government and entrepreneurship, who fear along with the reform processes a loss of their privilegies and power as well as loss in income and turn-over. The majority of Indian companies are not able to scope with foreign competition and to survive on global markets; exceptions are companies related to the Information Technology (IT). Thanks to revolutionary technological change in the service sector – growing at 8% plus – and IT, it is now possible for India to midway leave the slow industrialization route to development and follow-up the path of the other Asian countries with fast economic growth rates. The 5 billion US-$ software industry already employs about 200.000 professionals and offers enough opportunity for another 75.000 IT-professionals graduating every year. Prosperity in these two sectors has also helped create the maximum number of jobs in the last few years and resulted in sharp income growth rates (Outlook India, 2000, p. 3).

Unfortunately, the present government under Prime Minister Vajpayee, which consists of a coalition with seventeen different parties under leadership of the national-hinduistic Bharatiya Janata Party (BJP), has not been able by now to create a clear focused reform concept and to increase the slow speed of the economic reform process. It seems that too many different opinions cannot be brought together and that various interest groups in the government bloc important decisions. The same problem occured with the former government with former Prime Minister Kumar Gujral, which only lead the country for several months. Therefore, India is internationally called an „elephant“; it moves slowly, with patience but doesn't leave its way. As regards the foreign economic trade, numbers are decreasing after a starting period with promising numbers. Nowadays, there is hardly a minister in the present government who is willing and able to tie India in the world economy, to develop the internal and external reform-related sources and to generally increase the degree and quality of development within the reform process.

One important aspect of the rather slow development seems to be the constitution of the country; an official democracy with more than 600 million registered voters and more than 25 states within the Indian Union, which are guided separately with the same laws and rules as India as a whole (Wieck, 1999, p. 48). Democratic elected representatives in districts and communities exist with separate complicated quotas for women and minorities. The literacy rate is still about 50% (Bierbrauer, 1999, p. 198). Many state-owned companies are in huge debt. The infrastructure, especially the supply with energy, and new roads and railways is in a bad condition. However, India is – until now and against all pesimistic critisizers – a lifely democracy with 25 official languages and more than 3000 dialects within the unions, no single spoken official language but using the „imported“ English language in all courts. Is it possible under such circumstances that democratic structures consist effectively in the long run? A democracy developing with such negative prerequisites can only be called a „guided democracy“ rather than a „free democracy“; internal problems and instability are always a danger for democracy in long term thinking.

The in international comparison remarkably growing economy with a rise of GDP from 1.360 billion Indian Rupees in 1980/81 to a prognosticated 19.572 billion Indian Rupees in 2000/01 (see Table 2) seems to promise a better future, but actually conditions of production rather got worse.

Table 2: Development of Gross Domestic Product per capita in India, 1980/81 to 2000/01

	Indian Rupees	US-$*[1]
1980/81	1.360	172
1990/91	5.355	296
1991/92	6.168	252
1992/93	7.059	230
1993/94	8.770	255
1994/95	10.378	301
1995/96	12.180	283
1996/97	14.099	323
1997/98	15.636	421
1998/99	16.150	380
1999/00	17.316	390
2000/01*[2]	19.572	420

*[1]: Exchange rate Indian Rupee/US-$ in 2000 was 46,60.
*[2]: prognosticated

Source: Deutsche Bank Research, 2000, Country Brief Asia, p. 26; Center of Monitoring Indian Economy, 1999, Economic Survey 1998/99, p. S-7; own calculations.

Furthermore the engagement of foreign companies in India more or less gets hampered which at least partly seems to get back to an historical and deeply rooted „attitude of reservation“ towards foreign companies. Examples are the demonstrations and violent attacs towards restaurants of the fast-food giant McDonalds, in New Delhi and Mumbai (Bombay) in 1998; furthermore protests against Coca-Cola, Michel Jackson concerts and the like. Foreign investors are again seen in some parts as „conquerers“ and

„invaders“ as were the British until India’s independence in 1947. Moreover, the role of different religions and believes becomes more and more important since the violent attacs and burning of foreign christians in the state of Rajasthan in 1998 – followed by the burning of churches in the whole country which has shocked the world. After almost forgotten clashes between Moslems and Hindus, parts of the society now seem to focus an agressive potential on the different believes of Hindus and Christians. This trend is not only related to very traditional thinking members of castes of villages in the countryside, following a very caste-oriented and traditional life-style. Even parts of the more educated middle and upper classes in larger cities being more or less devided and separated through the caste system as well as well-known Indian industrialists seem to follow some of these thoughts. For a detailled discussion of the response of Indian business to economic liberalization and FDI see (Nayar, 1998, p. 2453-2466).

Second, the reservations against foreign companies seem to result through successful interfering of Indian companies and powerful interest groups, who do not want to accept any competition on profitable local markets. The fear is to loose market share and revenues in the long run. As interest groups, unions and members of political parties are very close connected and almost interrelate, it is very hard to distinguish groups and to convince them of positive factors of activities of foreign companies.

In July 1996 India got the status of a „dialogue partner“ within the ASEAN and got membership in the ASEAN Regional Forum (ARF). Furthermore, India accepted the South Asian Association of Regional Cooperation (SAARC) as an instrument of a better economic cooperation and understanding.

Nevertheless, prospects do not seem very promising: the government again announced to increase export rates in 1999 and 2000, which should be done with complicated export oriented programs and large subventions. But these are not in line with rules of the World Trade Organization (WTO). Other sources state the continuing negative trade balance (1995: -9,0 billion US-$ to -20,0 billion US-$ in 2001) as a long time burden (Deutsche Bank Research, 2000, p. 24). India has to import most of its oil and gas requirements and thus one can expect the trade deficit to widen over the years.

Further, Prime Minister Vajpayee was responsible for the realization of atomic tests in may 1998 leading to a deeply damaged image of India in the world. Sanctions of Japan and the USA followed these tests which were supported in India through most groups seeing India as a successful nuklear power country able to compete with other large nations worldwide. A national pride – also against the old rival Pakistan – arose within large parts of the Indian society.

2.2 Development of Reforms in PR China

As India did, PR China after a long time of independence and a single-oriented, internal focused existence started at the end of the 1970s with a carefully chosen and slow reform- and liberalization process.

After the foundation of the People's Republic in 1949 the foreign economic relations first focused on socialistic countries, mainly the former USSR. Relations to capitalistic countries almost collapsed. Only after the joined membership of China in the United Nations Organization (UNO) in 1971, foreign trade rates slowly increased. With the political meetings of the communist party (CP) in December 1978, a totally new phase of until then unknown economical changes was introduced, leaded by Prime Minister Deng Xiaoping (Song Xueming, 1998, p. 303). With the development of four „special economic zones" for foreign investors concrete projects of these fundamental changes were introduced. The object was to reform the socialistic economy with a step-by-step opening towards foreign direct investment. The relations of the chinese economy with the world economy continues to improve and increase from that time onwards.

With the approved reforms in 1978, the communist party (CP) introduced a fundamental change of the chinese economic system, which was related to large economic growth rates, an increased materialistic prosperity of the population and large changes in economic structures. The CP introduced a step-by-step transformation of the economy and a totally new system called „SOCIALISTIC MARKET ECONOMY“. A relation of elements of the old planning system and a new market economy was accepted as a compromise within different parties of the CP. This includes with the term „FOUR MODERNIZATIONS“ the sectors industry, agrar, technology/research and development as well as defense. The introduction of a non-state market-oriented sector next to a state-oriented planing economy was provided (Schüller, 1996, p. 278). GDP rose with a remarkable 11,7% p.a. from 1991-1995 and with 8% from 1997-1999, see Table 3 (Bundesstelle für Außenhandelsinformationen, 1997, p. 2 f.; Deutsche Bank Research, 1999, p. 23). However, some sources state a constant decline to about 6,4% in 2001 (Deutsche Bank Research, 2000, p. 18).

Table 3: Development of Gross Domestic Product per capita in PR China, 1995 to 2001

	US-$
1995	570
1996	670
1997	730
1998	770
1999	790
2000*[1]	860
2001*[1]	880

*[1]: prognosticated

Source: Deutsche Bank Research, 2000, Country Brief Asia, p. 18; own calculations.

The introduction of this „double" reform process and the slow liberalization also characterizes the foreign economic politics of PR China.

With the integration into the world economy and therefore a larger dependence from foreign countries and foreign markets, ideological opposition occured. This lead to a limitation of reforms to certain regions and segments of the foreign economic system. The object of the reforms was the adaptation of import- and export product structures to market demand and market supply in China and also abroad. With this policies, China was able to sustain important progress and success in foreign economic trade and was able to increase its world trade market share to approx. 3,5% (World Trade Organization, 1999, p. 2; Mrusek, 1999, p. 5).

However, China needs to place greater emphasis on the quality aspect in its development strategy, even if this initially leads to lower growth rates. This means that monetary and capital markets must become more efficient. That, in turn, will ultimately require greater currency convertibility and a more flexible exchange-rate regime. Too optimistic projections of authors (e.g.

Weggel, 1997, p. 226; Walker, 1997, p. 6) that in twenty years China will already be an economic superpower with total GDP comparable with that of the USA or even larger seem to take too little account of this important quality aspect. They rely too heavily on an extrapolation of past growth rates, they consider the chinese currency to be severely undervalued, and they are not sufficiently critical of the reliability of chinese statistics. This does not mean that China is no longer in its catching-up process. On the contrary: if the government succeeds in combining political stability – still its top priority – with the liberalization that is needed in an era of globalization, then the chinese success story should continue in the coming decades (Deutsche Bank Research, 2000, p. 17).

As regards the ASIAN FINANCIAL AND ECONOMIC CRISIS, foreign trade rates decreased due to a decreasing demand of chinese products (see 3.2). At the same time, China lost international competitiveness because of rising prices in the country. Until now, China did not yet depreciate the chinese currency Renminbi in order to improve the situation of chinese exports. A depreciation is seen as a large fear for Asian neighbour countries due to negative economic impacts in the Asian region; countries fear a further depreciation of their local currencies (The Economist, 1998, p. 5).

The increased integration of India and PR China in the international division of labour with the almost at the same time introduced deep-rooted economic reform programs has marked important progress. In both countries, the reform process goes along with various political and ideological clashes and opposition of different interest groups (for China see Gutowski, 1999a, p. 1 ff.). Despite that, the two countries face severe differences as regards the progress of world integration and the role in the world economy as a whole.

3 The Role of India and PR China in the Context of the East Asian Financial and Economic Crisis

The so called „EAST ASIAN FINANCIAL AND ECONOMIC CRISIS“ arose at a time when certain weaknesses and imbalances in the global economy were also prevalent. Before the crisis global growth depended on expansion mainly in the USA and East Asia. With the notable exceptions of China and Taiwan, the fast growing economies of East Asia, together with the USA, were the major contributors to global demand, which financed large external deficits by private capital inflows. In almost all industrial countries except the USA and United Kingdom exports were the engine of faster growth, especially in Japan and continental Europe, where domestic demand was sluggish due to restrictive fiscal policies. These disparities were reflected in increased exchange rate instability and trade imbalances; with Western Europe and Japan running large surpluses (UNCTAD, 1998a, p. 3.).

The direct impact of the Asian Crisis on global economic developments was not significant in 1997, although growth in the East Asian countries dropped sharply in the last quarter of the year. Growth in world output (production) increased slightly in 1997 and reached 3,2% while inflation remained low in most countries at levels not experienced since the 1950s. In 1997 international exports of goods increased with a rate of 9,5%. Despite the Asian Financial and Economic Crisis this are the best results since 1989 within the last two decades (UNCTAD, 1998a, p. 4).

But after 1997/98, while the developed world suffered little from the Asian financial crisis, the impact on the rest of the world has been dramatic. Virtually all developing countries and transition economies were affected. It played havon in East Asia and Russia throughout 1998, set back the progress achieved in Latin America, and in the most seriously affected countries wiped out the positive development of decades of economic growth and poverty reduction. In its wake, growth in the developing world slowed from almost 6% in 1996 to below 2% in 1998, and for the first time in ten years it was less than in industrial countries (UNCTAD, 1999a, p. II).

The two largest developing countries, PR CHINA and INDIA, have been striking exceptions in this otherwise bleak landscape. It is notable that both of these countries had resisted the temptation to pursue premature trade liberalization and rapid integration into the global financial system.

The spread of the financial crisis across the Asian economies during the second half of 1997 had a varying impact on output, exports and imports of countries in the region (see Table 4) and was greatest in South-East Asia, where growth rates fell by almost half from 1995/96 levels.

Table 4: Output and Trade of India and PR China in comparison to South-East Asian Economies, 1995-1998, percentage change of previous year

	Output*			Value of Exports			
	1995	**1996**	**1997**	**1995**	**1996**	**1997**	**1998**
India	7,2	7,5	5,0	20,8	4,1	3,6	-3,0
PR China	10,5	9,6	8,8	24,9	17,9	21,0	0,5
South-Korea	8,9	7,1	5,5	31,5	4,1	5,0	-2,2
Indonesia	8,2	8,0	4,6	18,0	5,8	7,3	-8,6
Malaysia	9,5	8,6	7,5	26,6	7,3	0,7	-7,1
Philippines	4,8	5,7	5,1	29,4	17,7	22,8	16,9
Thailand	8,8	5,5	-0,4	24,8	-1,9	3,2	-6,9
							cont.:

	Value of Imports			
	1995	**1996**	**1997**	**1998**
India	28,0	5,1	9,7	4,5
PR China	15,5	19,5	2,5	-1,5
South-Korea	32,1	12,2	-3,8	-35,5
Indonesia	26,6	8,1	-2,9	-34,2
Malaysia	30,4	1,7	0,8	-25,9
Philippines	23,7	20,8	12,2	-16,5
Thailand	31,9	0,6	-13,1	-33,5

**: based on data in constant prices.*

Source: UNCTAD, Trade and Development Report, 1999, p. 26;
UNCTAD, Trade and Development Report, 1998, p. 17.

Economic growth in South Asian countries as China and India also declined but for the first time in this decade total South Asian numbers (including that of Pakistan, Nepal, Myanmar and Sri Lanka) exceeded that in South-East Asia.

Export values fell in the most affected Asian economies in 1998; only the Phillipines registered a sharp increase. For developing Asia as a whole, the decline in export earnings amounted to 5,2%, largely because of a fall in the dollar prices of exports (UNCTAD, 1999a, p. 25). While the export value also declined in India (-3%), there still was a modest positive percentage in PR China (+0,5%).

Of the world's major economic regions, developing Asia recorded the strongest import contradiction in value terms in 1998. The value of imports fell by an unprecedented 17% and by as much as 31% for the five most affected Asian countries (ASEAN-4[3] and Korea). Imports only rose in a few countries such as India (+4,5%).

In order to explain the facts in Table 4, we must consider the large intra-regional trade numbers in Asia; therefore mainly the Asian countries were affected. The high degree of interdependence of trade and investment among the economies of East Asia – once a source of strength – was a major factor responsible for the poor export performance of countries in the region. More than half of the exports of the affected Asian countries are delivered to other Asian countries; they are highly integrated through trade. For example, in 1996 about 52% of Asia's total merchandise exports were sold within the region, while 54% of total imports were also *intraregional*. For various categories of merchandise, the share of exports absorbed by regional partners is even higher – 85% for mining products, 63% for agricultural products while the share for manufactured products is about 48%. As regards services, it is notable that the large tourism industry sector in Asia, with its vast array of *backward- and forward linkaged industries*, is dominated by intraregional trade. Intraregional tourists account for almost 80% of total tourist arrivals in Asia (UNCTAD, 1999a, p. 25; UNCTAD, 1998a, p. 27).

However, the role of India and PR China is different as regards the inner-asiatic trade and world trade. Therefore, the

[3] INDONESIA, MALAYSIA, PHILIPPINES AND THAILAND.

degree of affection and consequences are different. Although China's exports for the first five months of 1998 rose by 8,6% over the corresponding period of the previous year, they fell alone by 1,5% in May; for the first time in 22 months. From April to November 1997, India's rate of export growth to Asian countries was less than in the same period of 1996; with absolute declines in exports to Korea, Thailand and Singapore and reduced growth in exports to Indonesia and Hong Kong (UNCTAD, 1998a, p. 32). But the two large countries did not involve themselves to such an extent into intraregional trade as the other Asian countries did; therefore, comparable sharp declines did not occur.

Despite the financial crisis, FOREIGN DIRECT INVESTMENT (FDI) in Asia and the Pacific rose by about 8% to an estimated 87 billion US-$ in 1997, led primarily by increased flows to China (see Table 5).

Table 5: FDI Inflows, by Host Region and Economy, 1986-2000, million US-$

	1986-1991[1]	1992	1993	1994	1995	1996
India	177	233	574	973	1964	2382
PR China	3105	11156	27515	33787	35849	40800
South-Korea	863	727	588	809	1776	2325
Indonesia	746	1777	2004	2109	4348	6194
Malaysia	1605	5183	5006	4342	4132	4672
Philippines	501	228	1238	1591	1459	1520
Thailand	1325	2114	1804	1322	2002	2268 cont.:

	1997	1998	1999	2000[2]
India	3264	2200		
PR China	45300	45600	40400	17200
South-Korea	2341	5100		
Indonesia	5350	-250		
Malaysia	3754	3700		
Philippines	1253	1800		
Thailand	3600	6900		

Source: UNCTAD, World Investment Report, 1999, p. 52;
UNCTAD, World Investment Report, 1998, p. 364;
Die Welt, 24 July 2000, p. 12.

[1]: annual average
[2]: first six months

However, FDI inflows in 1998 to developing Asia as a whole have weathered the financial crisis that hit the region in 1997-98 and the economic downturn that followed. Flows into the region in 1998 were 85 billion US-$, compared to 96 billion US-$ in 1997. Although down – for the first time since the mid-1980s – by 11%, 1998 flows remained above the level of 1996 and well above the average of annual flows recorded during 1991-1995. The decrease in 1998 was almost due to a large decline in FDI flows to Indonesia (resulting in net divestment). Despite the disparate performance among individual countries most affected by the financial crisis, FDI flows into the ASEAN-4 and South Korea as a group remained resilient in 1998, down only about 1% from the peak level of approx. 17 billion US-$ in 1997. Viewed from the perspective of the prededing decade, 1998 inflows to those countries as a group stood up well, remaining substantially above the average of flows recorded during the 1991-1995 period (11 billion US-$). Nevertheless, individual national performance varied greatly. Inflows into Korea, the Philippines and Thailand showed dramatic increases. Malaysia showed a decline, while Indonesia suffered divestment for the first time since 1974. Korea received its largest-ever annual volume of FDI inflows in 1998 (5,1 billion US-$), a four fold increase over its average annual performance during the first half of the 1990s. The country became a net FDI recipient after having been a net FDI outflow country since the beginning of the 1990s (UNCTAD, 1999b, p. 56). Thailand experienced a dramatic increase in inflows (by approx. 92% from 1997 to 1998), as a number of weakened financial institutions were acquired by foreign investors.

PR China remained the single largest FDI recipient in Asia. Inflows to China were approx. 45,6 billion US-$ in 1998, a slight increase over 1997. While FDI inflows from within the region due to the Asian crisis declined by over 9%, flows from the USA and Europe increased by 21% and 3%. Faced with a number of adverse factors, including the negative consequences of the Asian crisis and the slow-down of economic growth, China intensified its efforts to attract investments. At the beginning of 1998, the Government revised its industrial guidelines for FDI. New incentive schemes for foreign investors, such as the exemption of import duties and value-addded tax on imports of equipment, were introduced.

However, FDI inflows are supposed to decline in 2000 due to various structural and economic reasons (Die Welt, 2000, p. 12).

FDI inflows to India, the single largest recipient in South Asia, were unable to maintain a level similar to that of 1997; the growth momentum of FDI into the sub-region was lost in 1998 (UNCTAD, 1999b, p. 58). Measures to encourage private investment and foreign participation in the domestic economy were strengthened in 1998. However, the success remains to be seen.

As regards the first year of the Asian financial crisis, the growth rate of FDI in 1997, however, was lower than that of the previous year (17%). As in the past, an overwhelming proportion of the region's inward FDI was directed to East and South-East Asia. Inflows to that subregion increased by 5% over 1996 to a total of 78 billion US-$, despite the financial crisis in Asia which erupted in July 1997. This was largely because flows increased to China and, to a lesser extent, to Singapore and Taiwan by a total of some 5 billion US-$ in 1997. Even in the five Asian economies most affected by the crisis (Indonesia, Korea, Malaysia, the Philippines and Thailand), overall inflows remained at a level similar to that of 1996. There were moderate decreases in flows into Indonesia, Malaysia and the Philippines, a sharp increase in Thailand, and almost no change in Korea. Remarkably, while flows into the other three declined, those to Thailand increased by over a half, although Thailand was the first Asian country to be stricken by the crisis. Furthermore, FDI approvals for these five countries together increased from 29 billion US-$ in the first half of 1997 to 32 billion US-$ in the second half of 1997 (UNCTAD, 1998b, p. 197 ff.). FDI was thus much less volatile than portfolio capital flows and commercial lending – both of which declined sharply in 1997 – because FDI generally represents long term interests in its host economies.

Compared with the large intraregional Asian trade numbers, we can monitor the same effects as regards FDI: investment among ASEAN member states is fairly significant. 28% of total outflows from Malaysia and 38% from Thailand went to other ASEAN member states in 1997. In the case of Singapore, 72% of its total outflows were invested in other ASEAN member states in 1997. The majority of FDI into China is also from other developing Asian economies; especially economies with large numbers of overseas Chinese residents: Hong Kong, Singapore and Taiwan. In 1987, outward FDI from South, East and South-East Asia directed to the same region was 2.833 million US-$; in 1997, the amount was as high as 40.008 million US-$ (UNCTAD, 1999b, p. 25).

In this context, it is important to note that the share of FDI in total resource flows to East and South-East Asia has increased remarkably in recent years; from 10% in 1990 to 53% in 1997. Indeed, FDI has become the single most important source of private development financing for the region, and it is likely to be particulary important for the economies most affected by the crisis, even if it should decline to some extent in the short-to-medium term.

Moreover, the heavy dependence of Asian Least Developed Countries (LDCs) such as Vietnam, Bangladesh, Cambodia, Nepal etc. on investments by firms from developing Asia, whose capacity to invest abroad had weakened due to the financial crisis, and the effects of the currency depreciation that occured in the most affected countries, has had negative implications for FDI flows into the LDCs. Therefore, the financial crisis in Asia has indeed led to a slowdown of the process of restructuring that had begun to facilitate the development of LDCs in the region (UNCTAD, 1999b, p. 59).

In contrast to portfolio investment and bank lending, FDI remained relatively stable as TNCs (particularly from the USA and Europe), continued to be very active in the Asian region. Some are restructuring their production networks in Asia to respond to changes in supply and demand patterns in the light of the fincancial crisis. Further FDI liberalization, the availability of cheap assets in some countries and the long-term prospects of the region have been the main driving forces behind TNC decisions to expand in developing Asia (UNCTAD, 1999b, p. 54).

Relating to this, more positive facts can be mentioned: efforts to attract FDI have been intensified in all of the crisis-affected economies of the Asian region and at all levels. The shortage of capital for financing production and trade, combined with the recognition of the role that FDI can have in restoring growth and development, has led governments to intensify their efforts to attract FDI. Recent moves include the further opening of certain industries (in particular, in the services sector) to FDI and the relaxing of rules with respect to ownership, mode of entry and financing. At the regional level, member states of the ASEAN agreed in October 1998 on the establishment of the ASEAN Investment Area. They have also undertaken measures to accelerate the realization of the ASEAN Free Trade Area and to grant special incentives and privileges to attrac FDI into the region (UNCTAD, 1999b, p. 54).

A general move towards structural reforms and economic liberalization in the 1980s led to the removal of controls on capital flows and introduction of full convertibility of national currencies in many developing countries. Within South-East Asia, Malaysia, Indonesia, Thailand and Singapore adopted such measures. Although India and China have been inspired by economic reforms in South-East Asia, capital controls still remain in place and the currencies are only partly convertible (on current account). However, policy makers in India and China announced long-term plans towards full capital account convertibility (CAC) with the object to integrate the countries more into the global economy (Bhalla, Nachane, 1998, p. 2373). This long-term objective is partly a response to pressures from the International Monetary Fund (IMF) refering to especilly China’s determination to join the WTO. With the number of overseas affiliates increasing rapidly, the chinese government is – of course – finding it more and more difficult to exercise control over capital accounts.

Concluding, we can state that PR China and India have escaped external shocks due to capital controls; the two currencies are convertible on current account but not on capital account. In recent years the IMF has viewed capital account convertibility as the natural follow-up to the establishment of current account convertibility. Free trade in goods and services is to be logically succeeded by free trade in financial and physical assets. In this context, it is interesting to note that KEYNES had always viewed capital mobility as incompatible with the preservation of reasonably free multilateral trade (Minsky, 1975, p. 6 ff.). Nevertheless, the empirical evidence on positive effects of CAC is mixed. Rodrik (1998) analyzed 23 countries in which capital controls were absent for certain periods between 1973 and 1996. He concludes that „*there is no evidence in the data that countries without capital controls have grown faster, invested more or experienced lower inflation. Capital controls are essentially uncorrelated with long-term economic performance*“ (Rodrik, 1998, p. 8 ff.).

3.1 India and the East Asian Financial and Economic Crisis

In India, the economic crisis in South-East Asia is almost not observeable due to the more or less closed domestic markets. Moreover, the role of India in world trade is with the number 0,5% not very important. Also, the fincancial institutional basis for fast transactions of speculative finances are not given (Bundesstelle für Außenhandelsinformationen, 1998a, p. 6 ff.). The Indian currency „Rupee“ lost in the first six months after beginning of the crisis only 8% of its value against the US-$; whereas East Asian countries lost between 17% (Singapore Dollar) and 80% (Indonesian rupiah). Some examples are given in Table 6.

Table 6: Bilateral Exchange Rates, June 1997-March 1998; percentage changes of monthly average

	US-$	Yen	Real Effective Exchange Rate
India	-9,5	2,2	-0,2
PR China	-0,2	12,7	2,9
South-Korea	-39,0	-31,0	-30,3
Indonesia	-73,9	-70,6	-63,2
Malaysia	-32,3	-23,5	-23,6
Philippines	-31,0	-22,1	-21,8
Thailand	-37,5	-29,4	-27,1

Source: UNCTAD, Trade and Development Report, 1998, p. 36.

India as the largest economy in the South-Asian region was cushioned from the effects of the crisis by its large domestic economy and by its restrictions on current accounts, which in effect reduced its exposure to the turbulence suffered by the international financial markets. India allowed its currencies to depreciate, which helped to maintain the competitiveness of its exports (UNCTAD, 1999c, p. 8).

Nevertheless, while the Indian currency declined in value in the wake of the Asian crisis (-9,5% to the US-$), the Chinese Yuan remained robust (-0,2% to the US-$) and actually appreciated in value somewhat in the months following the crisis, due to massive inflows of capital, a trade surplus and foreign exchange reserves. Despite cheapened exports of East-Asian countries after devaluation in the affected economies, China remains more export oriented and introduced measures to expand exports into new sectors and destinations. Furthermore, the Chinese response to the crisis is different from the Indian. For example, while the Indian government is wary of FDI and multi-national corporations, the Chinese continue to attract FDI as a channel of technology transfer and means of ensuring international competitiveness. In the wake of the crisis, the Chinese goverment has decided to accelerate reform of the financial sector, banking industry and state enterprises. Finally, like India also PR China plans to stimulate domestic demand through increased expendituree on infrastructure and housing.

Moreover, the impact of the Asian financial crisis on India has been less dramatic because of restrictions on capital account convertibility and more limited exposure to short-term foreign debt. India was extremely cautious on its approach to capital account convertibility. Indian corporations and banks are not allowed to borrow or lend capital abroad without governmental approval. This makes the Rupee much less vulnerable to changes in investor sentiment or to speculative attacks (Bhalla; Nachane, 1998, p. 2371).

Unlike countries in South-East Asia, the Indian economy remains less closely integrated with the global economy because of a rather gradual approach to trade liberalization, financial deregulation and privatization (UNCTAD, 1998a, p. 18). The creation of new regional arrangements such as the South Asian Preferential Trade Agreement is a step towards closer integration within the region and also with the world economy.

However, the large depreciations in the Asian region's currencies had and still have major implications for the pattern of international competitiveness both within and outside the region. The exchange rate movements are likely to alter international competitiveness among countries and trade shares in third-country markets.

The Indian trade deficit for the fiscal year 1998/99 was 18,3 billion US-$ and increased towards fiscal year 1997/98 due to increased imports with approx. 2 billion US-$. In 1997/98 goods with a value of approx. 34,9 billion US-$ were exported, but export value in the following year was with 35,7 billion US-$ only a bit higher than in the previous year. However, the value of imports rose in the same period from 51,1 billion US-$ to 54 billion US-$.

Imports are mainly oberserveable in the segments oil, gas and coal due to higher demand and a stagnation of domestic exploration. A higher demand due to a large potential of modernization is also notable in the segments energy, telecommunication and machinery. As regards food products, a further liberalization of imports is discussed in order to stabilize prices and to compensate own production deficits.

Reasons for the slow foreign economic trade and the increasing trade deficit are not very much related to the Asian Crisis; internal factors within the Indian country dominate the problem. With the introduced liberalization and the step-by-step removement of trade barriers since 1991 it got clear that Indian companies are not ready yet to scope with international competition; some are even afraid of foreign competitors (see also 2.1 Development of Reforms in India). As exceptions the growing industrial sectors software, construction and chemicals can be stated. The largest deficits can be found in the sector infrastructure and within this segment in the lack of supply of energy. But also the fast and inconsistent change of laws, rules and bureaucratic practices does not secure the planning and increase the willingness of companies for investments.

Foreign Direct Investment in India

As regards FOREIGN DIRECT INVESTMENT (FDI) the same problems mentioned before can be found. However, FDI flows to South Asia rose to another record level of about 4,4 billion US-$ in 1997, as compared with 3,3 billion US-$ in 1996, mostly reflecting an increase of about 37% in flows into India (see Table 5). India attracted 3,3 billion US-$ in 1997, less than the flows, for example, to Malaysia and Indonesia, and accounted for about 75% of total flows into the subregion. Some experts state that India's potential for inward FDI should remain substantial in the future (see UNCTAD, 1998b, p. 199); however, the number of new projects with foreign stakes is decreasing heavily. Also FDI inflow in 1998 decreased 33% compared to 1997 (UNCTAD, 1999b, p.24).

Further, the flow of finances in the first five months 1998/99 is less with 17% compared to the same period in 1997/98. Between April and July 1998 foreign investments worth only 97 billion Indian Rupees (IR) got approved; 14% less than in the same period a year before (Bierbrauer, E., 1999, p. 197 ff).

The LESSONS FOR INDIA to be learned from the Asian crisis is that there is no question that with the framework of economic liberalization and globalization, financial sector reforms play an important role, particularly from the point of view of resource mobilization. It is the process of financial sector reforms that consideration is being given to the introduction of capital account convertibility. But the question is whether India is macro-economically strong enough to face a convertibility in the near future. India's economic position is precarious in various aspects: sustainable economic growth, industrial production, trade deficit and a high level of fiscal deficit. Compared to China with approx. 157 billion US-$ on foreign exchange reserves, India only holds about 25 billion US-$ (Jha, 1999, p. 102). On top of all these, India's fast growing population, unemployment and poverty have to be kept into consideration in any macro-economic decision. The common formula of high interest rates, closing the budget deficits, lower inflation rate, shutting down failed banks and financial institutions and opening up of international capital markets is not necessarily applicable to each and every country situation around the world. The thrust of economic reforms has to be innovative and creditable; it has to be unique to each developing country's own situation (Jha, 1999, p. 103). However, the structure of the economy and the institutional framework have to be critically examined before considering capital account convertibility. Additionally, CAC would not guarantee successful economic performance automatically; there is no empirical evidence and correlation between openness on capital account and successful economic performance (Rodrik, 1998, p. 8).

Therefore, the Indian government nowadays faces a difficult situation. Its political power is mainly based on a hindu-nationalistic attitude which can be found in the slogan „India for the Indians“. Many companies supported the government due to economical reasons in order to receive protection against foreign competitors. It is a difficult situation for the government: foreign companies and the import of foreign products cannot be blocked too much; on the other hand it cannot be supported too much. Even if the government with Prime Minister Vajpayee would introduce a clear focused reform concept on the increased integration of India in the world economy, the integration could be blocked due to the opposition and interest groups in the state, local governments and private entrepreneurship. Therefore only limited success of integration can be prognosticated due to political reasons in the world's largest democracy. The role of India in a global world economy will probably not change too much in the future.

3.2 PR China and the East Asian Financial and Economic Crisis

Also in PR China, foreign trade rates decreased after the start of the Asian Economic and Financial Crisis. The demand for chinese products declined. But foreign trade only had a negative trend in May 1998; for the first time after 22 months. The development of exports was 2,1% lower in the third quarter of 1998. Between January and September 1998 the export value was 134,1 billion US-$; the import value was 98,8 billion US-$ so that China faced a large surplus of foreign trade of approx. 35 billion US-$. China's part on world trade nowadays is approx. 3% (Bundesstelle für Außenhandelsinformationen, 1998b, p. 5 ff.).

Compared to India, PR China got relatively strong affected by the Asian Crisis. The above mentioned trade surplus is mainly due to a relative low growth in import value and a different expansion of exports in the main trading countries of China. Although the strong currency devaluations had raised the competitiveness of enterprises in the affected Asian countries, they did not significantly increase their market share in the major developed country markets. China – by contrast – was able to compensate losses in exports to other Asian countries by higher exports to other regions. Despite the competitive pressure from other Asian countries, chinese exports to the following continents increased largely in 1998: European Union (+18,0%), both Latin America and the USA (+16%) and Africa (+27%) (UNCTAD, 1999a, p. 25 f.). At the same time, chinese exports to Asian countries lowered significantly. Compared with the year before, the countries imported much less: Japan (-7,0%), Korea (-34,0%), the ASEAN-countries (-16,1%) and Hong Kong (-2,4%) (UNCTAD, 1999a, p. 44). Official prognoses stating a growth of 5,4% in exports and 7,1% in imports are therefore not valid anymore. The decline of imports in China also affects very heavily the economic prosperity of Asian countries involved in the crisis.

The reasons for China to be named as „the country of stability in the middle of the Asian storms" (Financial Times, 1998, p. 6) is mainly due to the closeness of its capital- and exchange markets. The local currency is only convertible to certain balances of payment; therefore China got not affected by the huge waves of currency speculations like in South-East Asian countries. Also the fact that China's stock exchanges in Shanghai and Shenzhen are only open to a certain degree for foreign investors (Gutowski, 1998, p. 14) contributed to a less depreciation compared to South-East Asian countries (see Table 6).

Further, China holds approx. 157,7 billion US-$ on foreign currency reserves; the third highest rate world wide (after Europe and Japan). Additionally, 96,2 billion US-$ come from Hong Kong (International Monetary Fund, 2000, p. 5). Interventions to a large degree can be done in order to stop capital flows out of the country.

But even if China got less affected from the crisis as other countries, negative indirect matters as decreasing export rates, less growth of GDP and less amounts of FDI occured. Further, China has opened itself up to long-term capital flows, especially FDI, which brings with it human capital and technology, but it has resisted the temptation and pressure to open itself to volatile short-term capital, which in turn import huge risks, without commensurate benefits. „*The countries that have been most affected have neither been those with the most vulnerable financial systems nor those with the least transparency; one feature they have had in common is open short-term capital accounts, which appear to be critical variable in explaining the spread of crisis*" (Stiglitz, 1998, p. 2).

Related to the Asian crisis the burden of unfinished and uncomplete structural reforms in PR China got into the center of international attention. The chinese economy is described by some chinese and western economists as a „*balloon economy*" (Krugman, 1994, p. 62 ff.; Gore, 1999, p. 52 f; Xian Gao, 1999, p. 17 ff.). The difference to the East-Asian „*bubble economies*" – which are blowed up by financial and real estate speculations – is that politically guided massive investments are done in specific selected segments of the productive sectors. Such a „selected" development of the economy can considered to be positive for a time limited fast and heavy expansion of some industrial sectors. However, through the political intervention which is not oriented on market demand and supply, dangerous structural imbalances can evolve which are harmful for a long term sustainable economic growth (Heilmann, 1999, p. 94).

The chinese economy sustained its strong growth momentum in 1997, although it failed to attain the official target of 10%. Weak domestic demand was partly offset by a rise in exports. The prices of a wide range of consumer goods were reduced through a combination of administrative measures and macroeconomic policies. Township and village enterprises accounted for nearly half of the country's industrial output and one third of its exports in 1997. They were also responsible for GDP expansion at about double the rate for the economy as a whole. The Asian crisis has brought into sharper focus the need for government to give greater attention to problems in the financial sector and to adopt measures to enhance the effectiveness of monetary policy and restructure the assets of state banks (UNCTAD, 1998a, p. 17 f.).

China has been continuously reforming its financial system. Over the past fifteen years, the People's Bank of China has been turned step-by-step into a genuine central bank. Three policy banks have been established to take up the job of policy lending and the four state-owned specialized banks are being transformed gradually into commercial banks. Nonetheless, assessed on the basis of recognized performance criteria, the country has by far the weakest banking system of all countries according to an investment grade rating by agencies (Deutsche Bank Research, 2000, p. 16). The risks for the economy are limited, as banks are implicitly guaranteed by the state. In contrast to the situation of South-East Asian countries in the crisis, the banking system in China is still directly involved in the financing of government spending. Roughly one-third of funding from banks is provided on instructions from the planning authorities. The majority of other lending has also been subject to informal government influence, especially in the countryside.

Foreign Direct Investment in PR China

A comparable development can be seen as regards FOREIGN DIRECT INVESTMENT. Newly agreed foreign direct investments – mainly from the USA and Europe – increased slightly with 2,5% and were worth 35,8 billion US-$ in 1998 (Table 5). On the opposite side, investments from Asian countries decreased remarkably due to problems of the largest investment countries Japan, Korea and Hong Kong. The volume of new projects with the ten most important neighbour countries in Asia decreased 12%. However, in 1997 China was the „frontrunner" (with new record inflows of 45 billion US-$) and again accounted for over half of FDI flows into Asia and 11% of the world's total FDI (UNCTAD, 1998b, p. 198). The country continued to maintain its position as the second largest FDI recipient in the world and the single largest among developing countries. It was second (after Singapore) among Asian countries in FDI flows (UNCTAD, 1998b, p. 198). The boom was due to various factors: the country's large and continuously growing domestic markets, its export-oriented strategy and successful penetration of world markets, the liberalization of its inward-FDI regime, the spillover effects of industrial upgrading in neighbouring economies as well as the low level of FDI stock relative to size of economy (UNCTAD, 1998b, p. 202).

Nevertheless, China's FDI boom has now lasted for six consecutive years and since the financial crisis, which also took its part in FDI decline, the question arises whether this boom will continue. The rate of growth of FDI inflows has slowed from an average of 165% in 1992-1993 to 17% in 1994-1995; in 1997 as well as 1999 it declined further to 11%. Therefore, indications are there that there will be a further decline in FDI flows. FDI has mainly come from within the Asian region. Hong Kong, Taiwan, Singapore, Japan, Korea, Thailand and Malaysia rank among the top investors, accounting for 80% of China's inward FDI stock. The share of these countries in approved FDI in China in 1996-1997 is also high. However, the relevance of a slowdown in FDI is important for China. *Firstly*, a major change of inflows may have wide-ranging consequences for the Chinese economy, since FDI tends to be positively correlated with GNP growth. *Secondly*, developments with respect to FDI in China will have a sizeable impact on FDI trends in Asia and the developing world generally, since China has become the single largest FDI recipient among developing countries and the second largest recipient worldwide (see Table 5).

Relating to the reform and liberalization process, the liberalization of FDI policies is still under way. Some industries closed to FDI in the past are being opened up gradually; in particular, liberalization is continuing in such services as telecommunications, electric power, transportation, banking and insurance, and retail and wholesale trade. Furthermore, a significant potential exists for foreign investors to participate in building infrastructure and restructuring state-owned enterprises. The source of future FDI inflows will probably shift to a certain extent, reducing the role of firms from neighbouring Asian countries and increasing that of transnational corporations (TNCs) based in Europe and North America.

The economic development is also negatively affected by the large degree of instability of the chinese financial system. China's banking system is in an unstable situation due to political guided debts to state-owned companies. The volume of debts in the banking sector which are not repayable are supposed to be 30-40% of the chinese GDP (Heilmann, 1999, p. 101).

One central LESSON FOR CHINA from the Asian Crisis is to build a stable, monitored and controlled financial system before the continuing development of ecomic reforms; also considering the WTO-membership. The risky capital account convertibility must only be very slow developed in order to stop a possible flow of foreign currency out of the country. „*In a crisis maybe capital controls aren't such a bad idea after all. It will discourage some investors – but you don't want those guys anyway*" (Krugman, 1999, p. 80). Following up, we can note that financial liberalization without adequate safeguards was one of the factors causing the Asian crisis. China exercises central control on banks and corporations, which are not allowed to borrow or lend capital abroad without governmental approval. This makes the Yuan (like the Indian Rupee) much less vulnerable to changes in investor sentiment or speculative attacks (Bhalla; Nachane, 1998, p. 2374).

Refering to this background, some optimistic prognosticated growth rates of 8% p.a. over the years seem hard to reach, even when the performance of PR China in 1998/1999 is much better than compared to other Asian countries. Growth of GDP with 6,4% for 2001 seems to be more realistically (Deutsche Bank Research, 2000, p. 18). Next to the negative impacts of the financial crisis in Asia the Chinese economy suffers from structural weaknesses which also block the improvement of the foreign trade system (Weidenbaum; Sicherman, 1999, p. 4 ff.). Next to increasing social problems like large numbers of unemployment and internal migration (cheap „moving labour" from backward regions to prospering cities at the coast; 900 million farmers; Die Welt, 2000, p. 12), China suffers mainly from non-competitive chinese products, the low efficiency and productivity and large deficits of state-owned companies, backward provinces and finally lacks of development as regards the capital market. This facts also lead to an only slow development of foreign trade next to the Asian crisis.

4 Economic and Political Relations between India and PR China

The economic ties between India and PR China did not really improve during the last years; despite large trade amounts they are not very important in the world economic context. Main „customer countries" of Indian goods and services in 1997/98 are the USA and Great Britain, followed by Japan, Hong Kong and Germany. Most important suppliers are the USA, Switzerland, Saudi-Arabia as well as Germany and Belgium. Japan as the most important Asian supplier is 8^{th} with a share of 5,22% on total Indian imports. In turn, 31,5% of Indian exports are supplied to Asian countries (including Australia and New Sealand), but only 1% are imported by China.

About 25% of total Indian imports are supplied by Asian countries and Australia and New Sealand, but again only 2,2% are supplied from China. The degree of involvement in trade of the two countries is, according to the compared numbers, very low. China's role is very minor for Indian foreign trade (World Trade Organization, 1999). The reasons are very complex – some selected issues are analyzed below. It is important to realize that economic and political relations cannot be divided; they strongly interrelate each other.

The economic ties and the relation in general between PR China and India have been not very stable and contined in a more negative way since India's independence in 1947; the economic relations correlates with the political development between the two countries which is still volatile. Despite bilateral trade contracts foreign trade numbers in the past only grew very slow and remain at a low level (Behl, Mago, 1991, p. 263 ff.). After the border war between India and PR China in the Himalaya mountains in 1962, the relations totally broke down. India's suspicions of China stem not only from that war but also from China's close military relationship with PAKISTAN (Far Eastern Economic Review, 2000, p. 4). Only after the death of Mao Zedong in 1976 and the start of China's economic reform programms a new beginning with a slow start of communication, new diplomatic exchanges and trade was observed. But still, the border line nowadays is not clear; approx. 123.000 km² land in the Himalayas are still under negotiation.

One negative aspect in this context is the Indian „Shaki 98 Campaign"; the testing of five nuclear bombs in May 1998 with which India declared itself as a „nuclear power country" and a „world power nation" and articulated its claim to get a vote in the security council of the UN. The decision of India, which was followed by nuclear testings of Pakistan (also in May 1998), changed the degree of security in South Asia and put a heavy burden and load on the relations to PR China. Ironically, Indian Prime Minister Vajpayee himself started a visit to China in 1979 in order to start a new normalized relation with China, which discontinued abruptly with the nuclear testings. In a letter to US-President Clinton he undermined the tests with the constant threat of China towards India (Chengappa; Joshi, 1998, p. 28).[4] With his attitude and proud statements, Vajpayee could have lost twenty years of slow improvement of the relations to the sensitive neighbour (Swamy, 1998, p. 43 f.). India's relation to China was remarkably damaged through the tests; Beijing reacted officially „very shocked" (Nicholson, 1998, p. 7). It will take much effort in order to normalize the interrupted process of adjustment between the states. Nevertheless, harmonic relations between India and

[4] PRIME MINISTER VAJPAYEE SIGNED 177 LETTERS TO FOREIGN PRIME MINISTERS AND PRESIDENTS STATING THE REASONS FOR INDIA'S NUCLEAR TESTS.

China are very important for the economic and political stability in South and South-East Asia.

In a contrast to India, PR China is still a communistic state with a tendeny to socialism which is implemented through its „socialistic market economy“. However China is a widely recognized nuclear power nation and a constant member of the security council of the UN. Furthermore, it is a most appreciated economical and political partner for western countries with its remarkable economic liberalization and reform process since the late 1970s. India, the largest worldwide democracy, is still not that important to the West compared to its historic rival China. From the views of many Indians, this „hegemony of the status“ of China is due to chinese nuclear weapons (see for example Singh, 1998, p. 41 ff.; Sidhu, 1997, p. 10 f.; Mazumdar, 1998, p. 24 ff.). The nuclearization of India is on one hand the direct reaction to the chinese nuclear potential and its threat; on the other hand it exists to support India's role in world politics and the status of the country in order to compare itself with China and to increase its world wide status. *„The answer to an atom bomb is an atom bomb, nothing else*“.[5]

Another longstanding issue is that of the DALAI LAMA, to whom India has given refuge. During latest talks in June 2000, the Prime Ministers expressed appreciation of India's acknowledgement that Tibet is part of China as well as its commitment not to allow the Dalai Lama and his adherents to carry out „separatist activities“ on Indian soil. But, of course, both China and India realize that the Dalai Lama engages in political activities during his travel abroad (Far Eastern Economic Review, 2000, p. 5).

Unfortunately, with the started political approach also the trade relations could be improved and intensivated in the long run. The sustainable liberalization of PR China should continue in the future, so that India could benefit from the reforms if it would

[5] STATEMENT OF PRIME MINISTER VAJPAYEE IN 1964 AFTER CHINA'S FIRST NUCLEAR TEST, IN: MAZUMDAR, 1998, p. 24.

systematically improve trade relations with China and „set the right signals". This depends on the facts whether India and China have complementary trade structures and are competitors on world markets; they both export to a large extend the same primary products, textiles, chemical products and machinery. Other experts state that India and China to a large extend can be described as „rivals" rather than cooperative partners as regards long term future perspectives (Malik, 1995, p. 355). Others mention that there will always be differences between the two countries, so that it is important to build powerful constitutions in each country in order to secure and maintain harmonic bilateral relations (Far Eastern Economic Review, 2000, p. 6).

As regards the bilateral trade, main Indian export products to China are iron ore and minerals, tea, coffee, beans and steel products; iron ore and steel products account for 80% of total exports to China. India mainly imports raw silk, agrar products, herbs and spices whereas raw silk accounts for 50% of total imports from China.

But even if different opinions about the country borders (mainly along Tibet Province) are still applicable, signs are positive that trade rates between the countries will probably develop positively in the future including the new identification of potential import and export products (Srivastava, 1992, p. 285 ff.). For both countries foreign trade since the 1970s is getting more and more economical and political important. With almost half of the world's population China and India are – despite some critical aspects and above mentioned disagreements – very attractive markets which could develop positively; also due to the neighbouring geographic location.

It seems to be necessary to put in place concrete measures, e.g. direct flights between the two countries or the construction of a direct highway running through Myanmar (Burma) to link China and India. Setting up a joint economic committee to identify the areas in which the two countries can cooperate economically would be a step in the right direction.

However, it can be stated that both countries will play an increasingly important role in a globalized world economy in the near future, which should not depend too much on their tense bilateral relations. There are many similar but also different challenges for India and China with regard to the modernization of their large continents and the integration into the global economy.

5 Conclusions

The initial effects of the Asian crisis on India's and PR China's trade numbers and structures are mainly in form of reduced demand for their exports to East and South-East Asia and a decline in world commodity prices due to the recession in that region. The extent to which an individual country has been affected depends on the share of East and South-East Asian countries in its exports. So far the impact of the Asian crisis on PR China and India has been limited compared to South-East Asian countries. The contagion of the crisis can occur in several ways: through impact on exports, foreign capital inflows and the effects of contractionary domestic policies in the wake of the crisis (Bhalla; Nachane, 1998, p. 2376). Both India and China have escaped external shocks due to capital controls. The two currencies Rupee and Renminbi are convertible on current account but not on capital account. However, in both countries symptoms of financial ailments are evident: a lax banking supervision and control, high short-term debt and the ratio on non-performing loans to total loans, for example. Therefore, reform of the capital markets and banking industry are essential. Also a cautious approach is needed towards capital account convertibility due to the fact that the financial collapse of South-East Asian countries was the culmination of an inappropriate financial liberalization strategy with volatile capital flows acting as a triggering factor. The Asian Crisis has demonstrated the perils of free capital flows; unchecked by any regulatory device. This is one aspect of financial reforms where a slow-step integration seems to be recommendable.

However, it seems that the further integration of PR CHINA into the world economy cannot be blocked. Despite some internal ideological and political differences (mainly of certain interest groups) the quality and quantity of reforms will continue due to only one strong decision-making party, the CP (Gutowski, 1999, p. 43 f.). Nevertheless, FDI in China will probably decline in the long run. Although the financial crisis in Asia has not affected China that much compared to East-Asian countries, various structural weaknesses may slowly erode investors' confidence. In this context, it should be noted that FDI flows are an incremental measure; it cannot be expected that they will grow forever at the same rate, even if a host country continues to have a relatively high rate of economic growth. As long as FDIs fluctuate around a relatively high level, they contribute to the increase of assets for foreign companies and also play an important role in the host economy.

On the opposite side, INDIA has to legitimate political and ideological differences within its large democracy whereas China in its hierarchy only has a limited number of decision-makers. With the planned integration of China into the World Trade Organization (WTO) in the year 2000 a very important institutional progress will be achieved.

Compared to China, India's outlook as regards a fast integration into the world economy is not that promising. The main reason seems to be that the Indian government does not follow a clear focused strategic reform concept; too many changes from too many changing governments decrease efficiency so that foreign investors loose trust and interest. Further, international economic relations are not clearly focused and are hampered also due to economic problems. The disadvantage of India compared to PR China in this matter seems to be the non-existance of a united, active, reform-oriented political leadership. However, also China faces difficulties with its communistic government as regards social stability within the population as well as growing economic instability due to selected growth of sectors and regions (Heilmann, 1999, p. 95). Should China's economy really be a „balloon economy" which in the near future stagnates or even decreases due to the various mentioned structural reform deficits, long after the recuperation of the East-Asian countries after the Asian crisis?

It seems that for both India and China not the external shocks of the Asian financial and economic crisis will blockade chances of continuing reforms and modernization, but rather many internal problems on various levels.

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