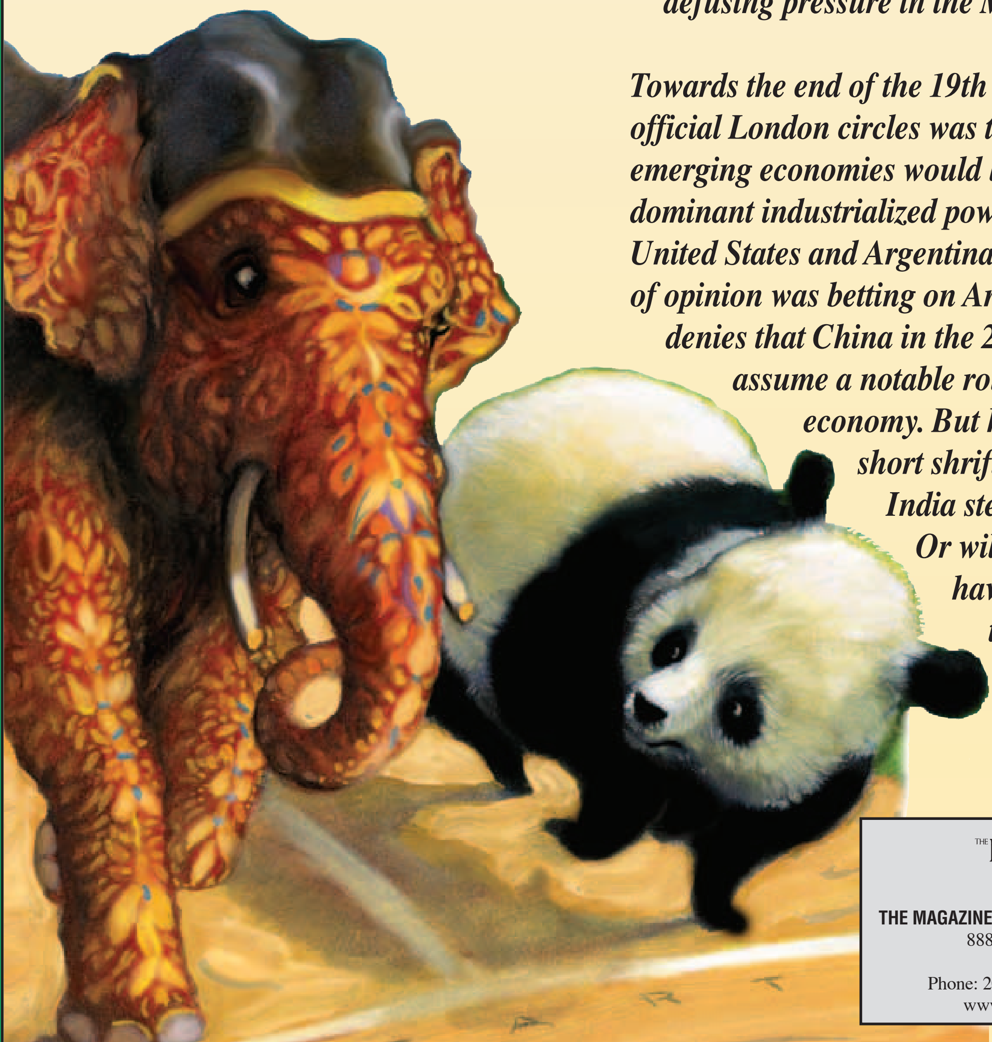
Will India Steal China's Thunder?

For most of the last decade, global strategists have fixated on China's potential to become a global economic powerhouse. What are the chances that while China continues to grow, India turns out to be the major new powerhouse in the global economy? After all, India enjoys

- *an educated class far larger than that of China;*
- *a huge English-speaking middle class population;*
- *a relatively predictable legal system;*
- *the likely potential for fewer demographic problems than China; and*
- *a globally strategic location allowing it to become potentially an important strategic partner with Europe and the United States in defusing pressure in the Middle East.*

Towards the end of the 19th century, the talk in official London circles was that at least one of two emerging economies would likely become a dominant industrialized power. The two were the United States and Argentina. Indeed, a large body of opinion was betting on Argentina. Today, no one denies that China in the 21st century will assume a notable role in the world economy. But has India been given short shrift? Will it turn out that India steals China's thunder? Or will all the problems that have hindered India in the past, including slow infrastructure spending, continue?



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India will absolutely steal China's thunder.

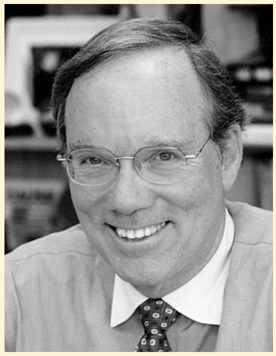
BARTON M. BIGGS
Managing Partner, Traxis Partners

India will steal China's thunder. In addition to all the reasons cited in the introduction, there are two other immense advantages that India possesses. The first is its democratic political system, and the second is the mature and transparent state of its financial markets. Without these two crucial ingredients of a great nation, China's social stability will always be questionable and its capital allocation process will be flawed. Neither will be smoothly or quickly implanted by China's Communist leadership.

India has been a democracy for decades, and a big, sloppy, inefficient one at that, plagued by weak, often transient coalition governments. Its fabulous growth trajectory has been achieved in spite of, not because of, government. In the early stages of an emerging country's development, a "benevolent" dictator and a strong central government has always been the formula we as investors look for. A young, rapidly growing economy needs to make tough choices expeditiously. It's difficult for a government that serves at the whim of the people to impose pain and demand sacrifices.

India has had for years functioning and transparent securities markets and an uncensored business press. Capital markets are a crucial part of the resource allocation system as is the dissemination of real news and true information. China has neither although it is now trying to remedy this problem. It will not be easy to nurture this fragile flower in the midst of a command political system and a command economy.

China now risks the backlash from fifteen years of singularly successful economic reforms. Although growth has been spectacular, it has created acute income inequality. Now increased household financial burdens for education, health, and housing have produced a fierce debate on the benefits of pro-market reforms. In terms of domestic tranquility and a stable society, the contrast between India and China is striking. China will eventually make the transition to a fair, capitalist, democratic society and the odds are that it will be painful and costly for the Chinese people, for its growth rate, and for foreign investors.



China, all the way.

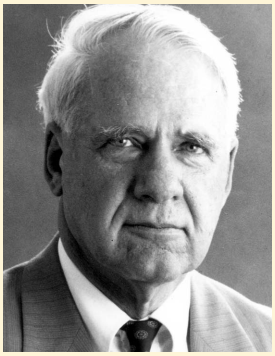
C. FRED BERGSTEN
***Director, Institute for International Economics, and coauthor of* China: The Balance Sheet—What the World Needs to Know Now About the Emerging Superpower (Public Affairs Press, 2006)**

India will not "steal China's thunder" in terms of its impact on the world economy because, even if its population comes to exceed China's and it matches China's growth rate over the next couple of decades, the closed nature of its economy will severely limit its global importance.

A country must meet three criteria to become a driver of the world economy: size, dynamism, and openness. India meets the first two. However, there is a vast gulf between China and India in terms of openness to the world economy:

- China's imports equal about 30 percent of its GDP, up from 5 percent when it launched its reforms in 1978. This is more than double the level of the United States and about triple that of Japan. The comparable number for India is less than 15 percent.
- China still maintains important trade barriers but its ratio of customs receipts to the total value of imports, the best measure of effective protection, is only about 2 percent. The comparable number for India is about 18 percent.
- Even China's applied level of tariffs averages only about 10 percent, compared with about 30 percent in India.

The results of these differences are stunning. The annual increase in China's trade is more than 50 percent greater than the total level of India's trade. China receives almost twice as much inward foreign direct investment each year as India has received in its entire history since independence in 1947. China has accounted for more than 12 percent of the entire increase in world trade over the past five years, almost twice as much as the United States or any other country and seven times as much as India. It is thus virtually inconceivable that India will "steal China's thunder" in terms of impact on the world economy at any point in the foreseeable future.



No, but India will share some of China's thunder.

JAMES SCHLESINGER
Former Secretary, U.S. Defense and Energy Departments, and former Director, Central Intelligence Agency

History is not predetermined. In a world of uncertainty and unpredictable change, almost anything can happen. Chinese growth could be stalled by internal unrest, or stopped by war or even loss of unfettered access to the American market. Such things are possible, but unlikely.

India has the advantages cited. Yet it had a later start than China, particularly in manufacturing. Its demographic burden is excessive population growth. As a democracy, it is obliged to yield in turn to various interest groups. Tensions with Pakistan—or even with its internal Muslim population—could readily grow. No more than with China can one be assured of smooth sailing.

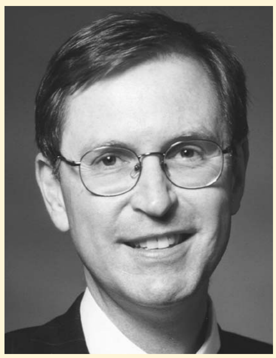
India likely will do quite well. Yes, bedazzled by China, the commentators have to some extent given India short shrift. Nonetheless, it is most unlikely that India will steal China's thunder. However, it will emulate China and share some of its thunder.

India will steal the spotlight.

MAYA BHANDARI
International Economist, Lombard Street Research

The Indian economy is poised to take off just as the Chinese "hard landing" is getting underway. As China's government-led and export and investment driven developmental model reaches its limits, India will almost certainly steal the spotlight, for these two reasons: First, the Indian growth model is far more robust than its Chinese counterpart and should take the economy on a much higher growth trajectory; and second, China faces more perilous challenges that will be harder to overcome.

Where India has successfully pursued human capital-led growth, China has relied on foreign direct investment to fuel growth. Although China's strategy has certainly borne fruit, in the medium to long term, technology or knowledge-driven growth is a much more powerful growth engine. India's effective banking sector and stock market—crucial financial infrastructure to support any high-growth economy—are almost absent in China. China's financial system is primitive, with most banks in the hands of the state. Indeed, this is the primary cause of the overinvestment and overheating that is likely to undermine Chinese growth (and a key reason for its shortage of innovative firms). India certainly faces its own challenges, including poor infrastructure, stifling labor regulations, and the need for agricultural reform. But against this, China must contend with a rapidly slowing economy, an essential but difficult transition to democratic governance, and even more difficult banking and capital market reform.



Both need to promote growth-promoting institutions.

GLENN HUBBARD
Dean of Columbia Business School and Russell L. Carson Professor of Finance and Economics, Columbia University, and former Chairman of the Council of Economic Advisers under President George W. Bush.

History and economic research tell us that the story of long-term economic growth is a story of successful economic institutions that promote entrepreneurship by protecting property rights and investors and advancing transparency and openness. The presence of entrepreneurship-promoting institutions explains the dominance of the United States in exploiting recent technological innovation; the absence of those institutions explains the failure of resource-rich Argentina and Russia to live up to their potential throughout the twentieth century or in recent years.

In Mao's China, real GDP per capita grew at an average annual rate of 1.8 percent. From the beginning of Deng Xiaoping's reforms in 1978, China's per capita GDP growth accelerated toward nearly 10 percent in recent years. This performance reflects greater openness and entrepreneurship. But China will not maintain this growth without more efficient capital markets (requiring greater investor protection) and a stronger banking system (requiring less official direction of credit). Such a warning is not abstract, as Japan's recent lost decade of growth prior to financial reform shows.

The improved performance of India's economy over the past quarter-century offers, as with China, an opportunity for both celebration and reflection. The doubling of India's GDP over the past decade has elevated living standards. But institutional reform is needed, with the development of industries hindered by labor market regulations pertaining to firms in the "organized sector" and slumbering state-owned enterprises. Such reforms, combined with India's well-developed private sector, would raise investment in growth.

The U.S. government rightly criticizes some aspects of Chinese and Indian macroeconomic policies. But it is the development of growth-promoting economic institutions that is, by far, the bigger deal.

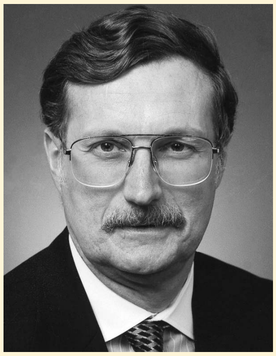
India probably will, though it's not inevitable.

STEVE FORBES
President and Chief Executive Officer of Forbes and Editor-in-Chief of **Forbes** ***magazine***

Yes, India will steal China's thunder, though it is not inevitable. India does indeed have advantages, such as an English-based legal system and a large English-speaking middle-class population. India is also not plagued by a problem with which China is about to suffer: a huge shortage of brides. China's one-child policy led to a widespread infanticide of female babies.

But India must deal with its own internal problems more aggressively than it has to date. Bureaucracies on both the national and state levels make the United States look swift and streamlined. Infrastructure in India is abysmally poor, as is the education system. While the country is creating an impressive pool of entrepreneurial, scientific, and mathematical talent, India still doesn't teach the basics of reading to hundreds of millions of young people. Actual illiteracy stands at more than 40 percent. Regulations in India still make it extremely difficult to set up a legal business, and its labor laws are rigid, in the style of Western Europe.

But what leaves one feeling optimistic is the fact that India is a democracy and that as its middle class grows so will pressures for pro-growth reform.



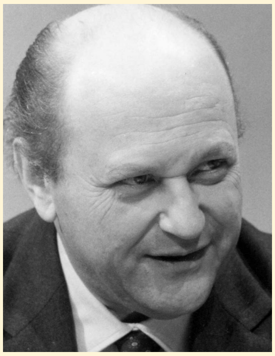
China will win out.

GEORGE HOGUET
Global Investment Strategist, State Street Global Advisors

India will not steal China's thunder. Twenty years from now both China and India will have made substantial progress in reducing poverty, but it is unlikely that India will catch up with China, given China's head start and private sector dynamism.

China's per-capita income on a purchasing power parity basis is already twice India's, and the math of compound growth rates is inescapable. The Chinese economy has a savings and investment rate roughly double India's, attracts annually more than ten times the foreign direct investment, and is twice as open as India's. China has made greater progress in human development, its fiscal situation is superior, and it is better positioned to withstand global shocks. India suffers from the legacy of inward-looking policies.

An orderly transition to more representative government in China is not certain, but China has generally viewed itself as a nation with a central authority, whereas historically India was a collection of princely states. Both countries provide attractive investment opportunities. Given differences in corporate governance, institutional development, and capital efficiency, the Indian stock market may generate better long-term returns. But China will remain the more dominant economy.

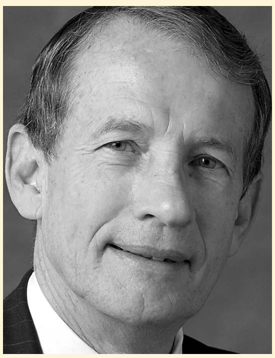


You can't rule India out.

RENATO RUGGIERO
Vice Chairman of European Investment Banking, Citigroup

Figures for the moment give China more chances than India to be the leading economy in the world twenty to thirty years from now. But history has proved to have more fantasy than figures. This is why it would be difficult to exclude the possibility of India becoming the new major powerhouse in the global economy.

In my opinion, the critical point is how India and China will develop their relationships in that period of time, and also the level of integration, including monetary, that will then be reached in Asia. A further factor is the kind of relationship the United States will be able to forge with Asia, in particular with India and China.



India's job will prove more difficult.

GARY CLYDE HUFBAUER
Reginald Jones Senior Fellow, Institute for International Economics

India has become the fashion of the day: a great prime minister, consistent GDP growth of 7 percent plus, a world-beating information technology sector, a booming stock market—all crowned by U.S. acceptance of India in the nuclear weapons club. Meanwhile China continues to resist RMB appreciation, doesn't rein in North Korea, punches well below its weight in the WTO Doha Round, and runs its stock exchanges like shady casinos.

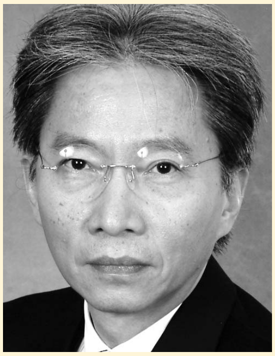
But competition between India and China over the next thirty years will largely be decided by which country can urbanize the fastest and the best. China is now 39 percent urbanized, India only 28 percent. Twenty years ago the urbanization figures were China 22 percent, India 25 percent. (By comparison, the United States and Japan are both about 80 percent urban today.) Indian cities are strangled by a ponderous legal system that practically guarantees dreadful infrastructure and sprawling slums. Every year China builds multiple new cities that accommodate a million or more rural migrants. Moreover, while India offers charming urban living for the rich, Chinese cities are far more livable for the middle and lower classes. My guess is that China will have an easier time learning democracy and English than India will have learning how to build cities.

India likely will win out.

SYLVIA OSTRY
Distinguished Research Fellow, Centre for International Studies, University of Toronto

Will India steal China's thunder? I don't know for sure, but think it likely. Anyway, the question involves much more than the China-India race. It involves an ongoing—and completely unsettled—debate concerning a new development paradigm. The buzzwords among political economists are information capitalism or knowledge capitalism or information revolution. The East Asian late industrializers replicated the industrial revolution albeit with far greater speed and with government industrial policies. But the new engine of technical change powering the structural transformation today is information and communication technology (ICT). India's comparative advantage in ICT (or the soft end) is well-known.

So can India leap-frog into the information age and bypass the industrial age? Those who are convinced it can argue that more and more services will become exportable and that off-shoring will become more and more feasible. Those who are skeptical argue that India's ICT industry is so far an enclave with little evidence of diffusion to the rest of the domestic economy and no linkages with the hardware of ICT at home or abroad. Major domestic and international policy reform is required. Still, India has the capability for reform, and democracy is an asset in the information age.



Not unless China stumbles badly.

FRIEDRICH WU

Visiting Senior Research Fellow, East Asian Institute of the National University of Singapore, and former Director of Economics for Singapore's Ministry of Trade & Industry

No, I don't think India will be able to steal China's thunder in the next twenty to thirty years, unless the latter stumbles badly on its own mistakes—a scenario which I do not expect to occur with high probability.

According to projections by Goldman Sachs and the OECD, China's GDP (at market exchange rates) will overtake that of the United States by 2041. By then China's GDP would reach US$28 trillion, while India's GDP would only hit $14 trillion (half of China's). Measured by purchasing power parity, the OECD predicts that China's GDP would overtake that of the United States by 2030. At PPP US$16.5 trillion, China's GDP would be twice that of India (PPP $8.6 trillion). In terms of per capita income over the same periods, China's would be twice that of India by either measure.

To date, India is still not a WTO member. It would take perhaps another five to ten years before India could join WTO. This means that many of India's economic sectors would remain protected and inefficient. China, on the other hand, has been a WTO member since December 2001, and is on target to open up many industrial and service sectors to foreign investment and international competition.

China is already a highly open economy compared to India. China is ranked as the world's third largest exporter and importer, accounting for 6.5 percent of world exports and 5.9 percent of world imports. The corresponding numbers for India are 0.8 percent and 1.0 percent respectively.

The trade-to-GDP ratio for China is 70 percent, while only 26 percent for India.

China also absorbs, on the average over the past five years, over 10 percent of global inward foreign direct investment, while India takes in less than 1 percent.

There has been so much hype about India's information technology sector. However, measured by broadband users per thousand people, China has 33, while India only has 0.4.

Lastly, India's dilapidated infrastructure is no match for China's. This is for all to see. It would take at least two decades before India could improve its infrastructure to China's present-day level. Meanwhile, China would move on and make further progress.

Having said this, I want to underscore that China and India are not necessarily competing in a zero-sum game. The rise of both economies should result in a win-win situation for the world economy. The more growth engines, the better for the world's economic welfare.

A cautious "no" to India making it.

LIONEL BARBER

***Editor,* Financial Times**

India enjoys three apparent advantages over China: demographics, better institutions, and more room to improve its policies and investment performance.

But these advantages tell us more about India's potential than its actual performance. Despite the recent surge in economic growth, India still lags behind China. India has not absorbed its labor force into productive employment, particularly in terms of shifting workers out of agriculture.

The pro-India camp will argue that free speech, the English language, a stable democracy, and a relatively predictable legal system trump Chinese dynamism. But India's stifling bureaucracy encourages restrictive labor regulation and compares unfavorably with China. Organized manufacturing has remained stagnant at around 6 million or little more than 1.5 percent of the labor force. The much-trumpeted information technology sector employs 1 million people, an impressive start but not enough to make a difference.

The biggest threat to China's economic miracle lies in the lack of legitimacy of the Communist Party and the widening gap between "insiders" who have benefited from growth and the "outsiders" left behind, mainly in the countryside. China must grow at its present roaring rate to absorb these outsiders—a massive political and economic challenge.

Over the next twenty years, it is possible but by no means certain that India will steal a march over China. To achieve this, the country's political and business elite will have to make a concerted effort to raise the rate of reform. At a minimum, this will require deregulation of labor markets, increased investment in infrastructure, and further trade liberalization.

So can India make it? Judging by past performance, my vote would be a cautious "no."

Possibly, but probably not.

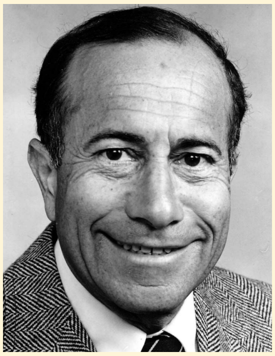
JIM O'NEILL
Head of Global Economic Research, Goldman Sachs International

Possibly, but probably no! When we at Goldman Sachs dreamed up the BRICs acronym in 2001, India was not really on the "map." After we highlighted the possibility in 2003 that by 2050, China could be the biggest economy in the world, the United States the second, and India the third in our BRICs "Dream" piece, we ourselves realized India's vast potential, especially with its very favorable working population dynamics. However, the India story has gotten a lot of mileage in the subsequent three years, and now, the idea that India is a "better" bet than China is common place. I suspect investors and thinkers might have gone a bit too far.

Don't get me wrong. The potential for India is fantastic, as it is for China, but India is not as close as people think. Due to the huge rally in the stock market, Indian valuations are no longer cheap, and any disappointments in the future might start to be punished. They now have a growing balance of payments deficit, and the government still struggles to implement some key policies. I would like to see India agree on plans for more clearer macro policies. Why not introduce an inflation target as a policy anchor, for example? They also need to implement plans for more foreign direct investment.

While India has an educated elite, the strength of its education is to some extent a myth. In December, we developed a growth environment "scoring" system consisting of thirteen variables that drive long-term productivity. One of them is education, measuring its breadth throughout the population. India scores much lower than China, indeed, lower than all the BRICs. On the aggregate index we put together for 170 countries, India ranks lowest for all the BRICs. China ranks highest.

Both China and India have huge potential, but they both have many challenges, largely of a different nature. China has probably less immediate ones than India. Despite this, the potential for both so long as globalization is allowed to continue is enormous, and they should be allowed and encouraged to flourish. To help this, and improve the world, it is becoming more and more imperative that the "G" organizations are reformed and able to help. The G7, G8, G20, International Monetary Fund, World Bank, and maybe even the United Nations all need to be urgently overhauled and strengthened to help China and India develop more, respond to their challenges, and contribute to a more stable and stronger world economy.



Their relationship is likely to be predetermined.

CHARLES WOLF, JR.
Senior Economic Adviser and Corporate Fellow, International Economics, RAND

The question conceals an unwarranted assumption: namely, that the "thunder" to be acquired is fixed, so India's acquisition of more would be at China's expense. The reality is different. If one construes the thunder metaphor in terms of GDP growth and what contributes to it, the relationship between China and India is more likely to be complementary than competitive.

If and as India sustains its high rate of growth (about 8 percent annually), its trade with China will expand from the low levels of total trade in recent years; similarly and reciprocally for China's growth (about 9 percent) and its small but growing trade with India. Bilateral trade will grow as their economies grow.

Foreign direct investment—an important multiplier in China's growth—is an order of magnitude greater in China than in India. If the climate for foreign investment is improved in India—by appropriate regulatory and tax measures, and by protection of property rights—the ensuing increase in foreign direct investment in India is likely to be additional to that in China rather than substituting for it.

But not everything is complementary. China and India are respectively the second and fourth largest importers in the world oil markets. As each economy grows, its rising energy demand will tend to boost world prices, imposing an extra burden on the other.

Neither will become an economic superpower.

TADASHI NAKAMAE
President, Nakamae International Economic Research

Neither China nor India will become an economic superpower—in terms of GDP—within the next twenty years. India's best hope is to achieve parity with China by maintaining a higher growth rate than its rival.

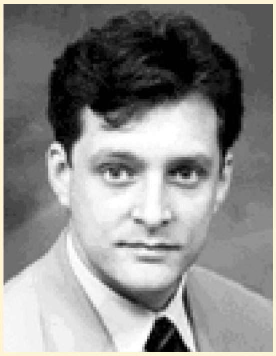
In 2004, India's GDP was \$0.67 trillion and China's \$1.65 trillion, while Japan's GDP was \$4.67 trillion and America's \$11.7 trillion, according to IMF data. If China and India were to grow at an annual rate of, say, 7.2 percent over the next twenty years, the size of their economies would quadruple to \$6.6 trillion and \$2.7 trillion respectively. Japan would have to expand only 1.7 percent annually during this time to stay ahead of China.

While Japan's position as the second largest economy in the world is unlikely to be threatened, China may find India nipping at its tail. Should China's growth rate slip to 2.5 percent per year, while India's remains at 7.2 percent, India's economy could outgrow China's. This is not improbable: China has already enjoyed two decades of 7 percent-plus annual growth, and will struggle to sustain this for another twenty years. During Japan's rapid expansion during the 1950s and 1960s, it only managed twenty years of rapid growth. After an oil shock in 1973, Japan's annual growth rate slowed from 10 percent to 4 percent, and stayed flat until 1990. The reasons for Japan's slowdown—energy and resource constraints, a decline in the number of young people, currency and trade pressures—are strikingly similar to the challenges China faces today.

As another energy crisis looms, the effects of China's one-child policy, implemented in 1979, are starting to hurt. Add in the other challenges, and it is reasonable to believe that the era of rapid Chinese growth has passed.

By contrast, India's drive to industrialize is still in its infancy enabling its average growth rate to surpass that of China's over the next twenty years. Still, excessive market expectations for India are unrealistic. There are natural limits to growth in an economy with more than one billion people. India's population is ten times larger than Japan's, which suggests its economic hurdles could also be magnified ten-fold.

India's best chance to draw even with China is to pursue slow and steady economic growth in order to avoid problems caused by its large population.



India's chances aren't nil, perhaps just 10 percent.

DANIEL H. ROSEN
Principal, China Strategic Advisory, LLC

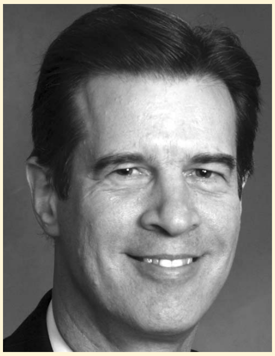
For India to have stolen China's thunder twenty years hence, two things would have needed to happen: acceleration in India and deceleration in China.

Acceleration in India would require a marked uptick in urbanization, which while positive today is nowhere near the rate of urbanization in China. It would also require much further liberalization of trade and investment barriers, and better attention to social ills to strengthen the political consensus that pro-growth is pro-poor (despite its democracy, Indian poverty is more wrenching than China's).

Deceleration in China would most likely occur as a function of lost political consensus for growth and openness; falling competitiveness due to the high cost of emergency environmental measures; or a seizing-up of international trade due to conflict over Taiwan or some other trigger.

The challenges of acceleration in India are more difficult to solve than forestalling deceleration in China. The government of China has huge assets that can be brought to bear to address challenges. Fissiparous India needs at least a decade just to establish a sovereign credit rating on par with China's, and after achieving that kind of parity could not catch up to and surpass China in another decade even if China partly dropped the ball on its own challenges—it would just take more time.

Japan taught us at great cost that a high-growth economy can turn on a dime to generate zero growth for more than a decade, and we owe it to them not to forget that such stumbling is possible. So we can't put the chance of India stealing China's thunder at nil; perhaps 10 percent would be a fair probability. But moreover, a 10 percent growth China and 7 percent growth India are both phenomenal, and together they will add a lot of thunder to the world economy, stealing it from some, and strengthening gains for others.



Not unless China stumbles.

WILLIAM H. OVERHOLT

Director of the RAND Center for Asia Pacific Policy

India will likely succeed because of spreading elite consensus on market-oriented reform. No company can call itself global without a major India presence. But it is unlikely to surpass China unless China stumbles. China's infrastructure and mass education are vastly superior and likely to remain so.

India is beginning to build infrastructure, but India's patronage system makes its expenditures less efficient than those of China. For instance, India spends more on primary education, but unlike China, half of Indian women remain illiterate. The roads come out much lower quality. Soon China will have more English speakers than India. Whether India's overburdened courts or China's overly politicized courts improve faster remains to be seen.

India's successful areas may have the same demographic problem as China, and India will not be able to use its overall demographic advantage so long as it fails to educate its non-elites. Because India's manufacturing sector remains hampered by residual politicized regulation, India is not creating jobs or urbanizing fast enough to take full advantage of globalization.

India's premature great power pretensions and military ambitions, in contrast to China's higher priority for economic development, will hamper its relative economic performance. India's clear advantage is the soundness of its banking system and capital markets. Portfolio investments in Indian companies will greatly outperform China.

Yes, if China stumbles and India ramps up reform efforts.

DANIEL GRISWOLD

Director, Center for Trade Policy Studies, Cato Institute

It is tempting to view the emergence of India and China as a horse race, but development is not a win-lose arena where one country's success is another's loss. India and China can prosper together. The growth and development of each of the world's only two "giga-countries" will depend overwhelmingly on the extent to which their governments pursue market-oriented reforms.

So far, China has moved the most decisively in the market direction. Its economy is more open and its labor market far less regulated than India's. As a result, China attracts about ten times more foreign direct investment than China. Its international trade sector is much larger and its annual GDP growth several percentage points higher.

Despite those advantages, there is a real possibility that China's economy could stumble in the next decade or two because of the inability of its non-democratic central government to accommodate the aspirations of a growing middle class. Increasingly, the government will be forced to implement necessary reforms—in banking, currency exchange, telecommunications, and property ownership, and so on—that require it to surrender control over it citizens. At some point, China's rulers will need to choose between continued growth and preserving their monopoly on political power.

While India's economy is currently less open and flexible than China's, its vibrant democracy allows it to implement reforms without risking a political crisis. If Prime Minister Manmohan Singh and his successors can continue on the steady road to more economic freedom, India could soon achieve China-like growth rates. Their primary challenge is how to spread the blessings of market growth beyond the open, deregulated, and spectacularly successful high-tech sector to the still overly regulated and protected rural and manufacturing sectors.

If India can successfully reform its economy and China its political system, the future is bright for both countries and their 2.5 billion citizens.

India will have to overcome limitations.

EUGENE R. DATTEL
Veteran Wall Street professional and author,
The Sun That Never Rose: The Inside Story of Japan's Failed Attempt at Global Financial Dominance *and* Cotton and Race in America (1787–1930): The Human Price of Economic Growth *(2006)*

The drama of India's current economic boom has been fully captured by the press, public policy spokesmen, the financial community, and the academy. Will India become a global economic giant that will both compete with and threaten today's powerhouses? Or is India merely this decade's fashionable economy?

Perhaps a little perspective is required. Since World War II, America, (twice) Russia, the Middle East, the European Union, Japan, and China have been regarded as real or potential economic giants. This status was usually accompanied by exaggerated predictions of economic dominance, undue influence, or the threat of competitive pressure which would lead to loss of national sovereignty.

None of these extreme forecasts were accurate. None of the threats materialized. Each country or entity was subject to internal structural flaws or external forces which prevented ascendancy.

India will be subject to the same limitations. While India will become a recognized international economic force, its massive social problems, inadequate legal and financial systems, and uneven growth pattern will surely present obstacles. Indeed, a nation's ability to deal with change and accountability—its corrective mechanism—is vital for long term stability and growth. India, as well as China, will be tested severely.

Many of the same voices that extolled Japan and China have now lurched towards India. The dialogue about national winners and losers too often resembles that of a sports contest between two countries. Will India eliminate China from World Cup competition? In reality, particular industries or sectors compete. Government policies do encourage specific entities or areas, but this usually has unintended negative consequences in other parts of the domestic economy.

One can safely predict that the world's investment bankers will remain agnostic. As intermediaries, they are particularly adaptable. If a country has excess funds, they will provide assets. If a country requires investment, no promotional effort is spared in enticing money from institutions or individuals.

No, India is too socialist.

ROGER M. KUBARYCH
Adjunct Fellow, Council on Foreign Relations, and Senior Economic Advisor, HVB Americas

India will not steal China's thunder. India is too socialist to move as quickly and as forcefully as China. But even a slow track improvement in India offers promising investment opportunities to the patient foreign investor.

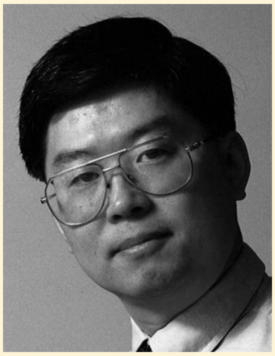
Not unless India breaks out of its reform inertia.

CHI LO
Author of* Phantom of the China Economic Threat, *Palgrave Macmillan (upcoming 2006)

The biggest obstacle to India outperforming China is reform inertia. China has embraced structural changes and strived to remove the remaining vestiges of its Communist past, notably the state-owned economy. India seems to have stuck with a "leftist" mindset and blocked privatization. India's poorer reform attitude, as seen in its lesser trade liberalization and foreign direct investment share in the economy, has trapped its growth momentum below China's.

Yes, India has the English language and better legal and institutional frameworks. But China is catching up with significantly stronger reform momentum. Beijing is experimenting with scrapping socialist icons, like the household registration system and state lending, while New Delhi's will to push basic reform, such as labor market reform, is not visible.

Arguably, China's uneven development between the east and west regions and the banks' financial woes are controllable by macro and structural policies. Its key growth obstacle is its aging population. But unless India breaks out of its reform inertia, its more favorable population dynamics will not help it win over China. The issue comes down to choice. If India chooses to preserve its unique past, it does not have to compete in any growth race; there is a price to everything.



Both will stand out.

YONGHAO PU
Regional Head and Chief Regional Economist, Wealth Management Research Asia-Pacific, UBS

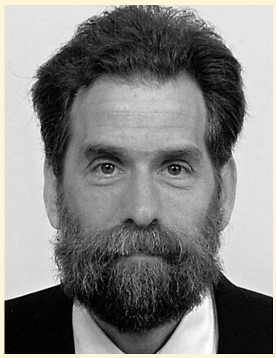
I would envisage that China and India both become the major new powerhouses of the global economy in the next twenty to thirty years, rather than one replacing the other. Why? The two economies have very different structures and institutional frameworks. On the one hand, apart from having a strong service sector, India has a very youthful demographic structure compared to the aging population of China. With 35 percent of its population now below the age of fifteen, the Indian working age population is projected to increase by 335 million by 2030. This dynamic supports higher and sustained growth. On the other hand, the challenges to India's growth potential are many. In addition to poor physical infrastructure, heavily protected industries, and an underdeveloped private sector, the Indian administrative and legal system is also very bureaucratic. All of these have hindered foreign investment, a critical ingredient to the development of a modern manufacturing industry.

In China, however, the manufacturing industry is the largest and fastest growing sector, and labor costs remain very competitive. In the past twenty-five years, China's per capita GDP increased almost six fold, to US$1,700 in 2005. However, China's hourly labor cost is still only 5 percent of that of the United States, or 12 percent of the hourly labor cost in Korea. Therefore, the country's manufacturing industry is likely to remain globally dominant in the coming decades, even with continuous appreciation of the currency and slower growth in labor supply. In conclusion, I would foresee that both economies will stand out as new global economic powerhouses, while playing a very complementary role to each other.

Yes and no.

JON THORN
Managing Director, India Capital Fund

Yes and no. People globally have only just woken up to the Indian opportunity. It is huge. But China has shown it can take more effective action to grow GDP. GDP growth is primary. Everything else is footnotes. India can move ahead faster from here than China, but its political class will have to achieve that. But together, both China and India are the growth stories for our lifetimes.



No!

GARY KLEIMAN
Senior Partner, Kleiman International

No, India will not steal China's thunder. While focusing on the last two of the big BRIC developing economies is a natural tendency, from a broader emerging market perspective Asian neighbors will be powerhouses in their own right, particularly those that have endured the financial shakeout not yet associated with China's banking or India's domestic debt woes. South Korea has exited from crisis as a sophisticated high-tech and capital markets center. Malaysia has positioned itself as a conduit for Islamic finance and investment outside the Middle East. Indonesia is again able to harness its vast natural resources in contrast with the two commodity-dependent giants. In Asia's coming decades, China and India will exploit their size and respective manufacturing and services advantages, but multiple emerging market competitors from within and outside the region will be counterweights.

Both will be important.

GREG MASTEL
Chief International Trade Adviser, Miller & Chevalier

China and India have emerged as strong competitors in labor-intensive manufacturing and service sectors. It is likely that both will be important players in an increasing number of industries in the next decade.

China and India, however, have a history of strongly preferring home-grown companies to Western producers. As a result, Western companies—particularly U.S. companies—will need to work to protect competitive advantage, including patented processes, technology, and general know-how, when operating in either country. The focus should be less on choosing between India and China—in the end, the market will make that choice—and more upon developing corporate and national strategies for operating in or competing with those countries. Often, part of that strategy is likely to involve hedging bets by operating in both markets.

Yes, India's barriers are easier to overcome.

PAUL J. ALAPAT, PH.D.
Managing Director, Amba Research

My forecast is predicated on what I perceive to be currently priced into conventional wisdom, and on what I judge to be the obstacles that lie ahead of the two countries in the future, and tempered by my experience of living over a decade each in China and India.

On the first point, markets have forecast the next fifty years by extrapolating current rates of economic growth. Yet it is much more likely that China's 9 percent plus rate of economic growth will revert to a lower more sustainable number, while India's 6 percent plus rate is more likely to rise as unexploited resources are tapped. Demographics, physical infrastructure improvement, and private property rights all favor India and are likely to play out to surprise current expectations.

The barriers to India's sustained acceleration are largely in terms of physical infrastructure, or the lack of it. In many ways, these are the easiest obstacles to overcome and they will be.

China's challenges are far more profound. Align political freedom better with its economic freedom and rising income levels, and address income inequality and insolvent banking systems. These issues can be delayed, but will need to be confronted at some stage. Their resolution could prove fairly disruptive.

No, China will win out.

IL SAKONG
Chairman & Chief Executive Officer, Institute for Global Economics, and Former Korean Minister of Finance

No, India will not steal China's thunder. At least for a couple of decades to come, China will surpass the Indian economy with higher growth rates. My prediction is based on the two nations' relative strengths in their peoples' aspirations to getting their old glory back, their leadership structure and its commitment to economic growth and development, their industrial structure and reliance on foreign direct investment, and labor market and bureaucratic flexibility. Despite the challenges of reconciling the socialist state and market-oriented economy, closing the large regional income gap, and alleviating the high non-performing asset problem, China will manage to grow faster than the Indian economy—which will also grow fast—until it reaches a per capita income level of, say, \$4,000–\$5,000.

India might well share the thunder.

STEPHEN GILMORE
Strategist, Banque AIG

India will not steal China's thunder, but might well share it. India is unlikely to catch China in terms of total GDP or per capita income in the next few decades. China has too big an advantage in its starting income level, superior infrastructure, and higher investment rate. But will India become relatively more important in the global economic context? The answer is almost certainly yes. To date, China has had a greater impact, not just because of the size of its economy and its growth rate but also because of the openness of its economy. China has also been effective in tapping its current area of greatest absolute and comparative advantage—its labor pool.

India has not been reliant on the external sector for growth with its economy remaining relatively closed. However, the country has been reducing barriers to trade and the economy is quickly becoming more open. Favorable demographics also mean that India should be an important contributor to consumer demand over the next several decades, especially if reforms take place in the labor market so as to encourage greater participation rates.

Attitudes toward foreign investment will determine all.

YASUO KANZAKI
Special Advisor, Nikko Citigroup Limited

The economic growth gap between the two countries reflects their different attitude to foreign investment. Since Deng Xiaoping's revival at the end of 1970s, China has rapidly industrialized its economy by favoring foreign brand names. India has adhered to a policy of industrialization by its public-sector enterprises and remained closed to foreign investment until its currency crisis in 1991. This was a historical reaction to India's experience as a colony in which the colonial master distorted the Indian industrial structure for its own profit. However, during the its period of isolation, India's indigenous entrepreneurship was nurtured and its own technological education system developed. The homecoming of numerous non-resident Indian information technology workers, who have mastered global business skills in American and European companies after the graduating from their mother country's education system, has driven the rapid development of India's information technology service industry.

India's nuclear policy was also an obstacle to attracting the developed countries' investment in the 1990s. However, the United States and the European powers have now begun to collaborate in India's nuclear development because of its geopolitical position as a reliable Asian partner.

India's UPA government gradually promotes its economic reform by placating the left wings who cooperate with UPA outside the cabinet. India is expected to maintain a stable economic reform trend under its democratic political system as its workforce population grows.

India's advantages will probably prevail.

BERNARD CONNOLLY
Global Strategist, Banque AIG

India's advantages are demographics and the rule of law. Its disadvantages are the remnants of the ossifying caste system, a venal bureaucracy, a legal system that makes Dickens' Jarndyce and Jarndyce look like a model of efficient case management, protectionism, and a defensive attitude to any foreign investment, such as Tesco's, that highlights a need for dynamic employment change.

But the demographic advantages will probably prevail in terms of earning India the lion's share of inflows over the next two or three decades, as capital flows to where the biggest pool of low-wage workers is found. That is double-edged from a global perspective: unlike China with its one-child policy, India does not face structural constraints on consumption.

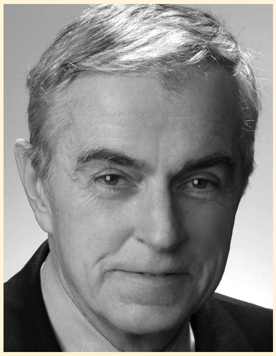
India will probably (and appropriately) run current account deficits for a long period. Much of the flow into China is recycled via foreign exchange reserve accumulation. China thus helps to keep a global Ponzi scheme, and notably U.S. over-spending, from collapsing. If India does in the future steal China's thunder on capital flows, domestic demand in the United States could be in for a very hard landing, and there would—through no fault of India's—be a serious risk to the world financial system.

India enjoys a services advantage.

DIANA FARRELL
Director, McKinsey Global Institute

China is pulling ahead of India on the strength of its manufacturing. But India's brainpower gives it an advantage in services, a better basis for future prosperity. India's pool of college graduates qualified to work in world-class companies is more than twice the size of China's. Although China produces 1.7 million college graduates each year, most lack the language skills, practical experience, and work habits required by globally competitive companies. Out of China's 9.6 million young professionals in occupations such as engineering, marketing, finance, and software development, for instance, only about 10 percent would be hired by a multinational, according to local recruiters, compared with 14 percent of India's 14.2 million young professionals.

India already excels in services for export, and domestic services comprise a much bigger share of the total economy than in China. This matters because, as economies mature, services provide an increasing share of GDP and jobs. Advances in technology and productivity mean that manufacturing will not be a reliable source of new jobs anywhere; not even in China, which has shed 15 million manufacturing jobs in the past ten years. But 60 percent of Indians are still underemployed in agriculture. India needs to redouble its effort to reform its economy in order to create the new jobs that will raise its living standards above Chinese levels.



Both will learn from each other.

RICHARD ERB
Research Professor, University of Montana, and former Deputy Managing Director, IMF

Will India steal China's thunder? Before looking to the future, it may help to look at the recent past.

Forget about the Washington Consensus nonsense—most countries watch and learn from each other. During the 1970s China watched its neighbors to the east and south surge ahead as they implemented open market economic reforms. In turn, China's own variation of market-oriented economic reforms begun in the late 1970s and early 1980s produced phenomenal results.

In India, China's success catalyzed broader political support for those who had been laboring to implement economic reforms for many years. As a consequence, a highly skilled and dedicated group of Indian civil servants, led by the current Prime Minister Manmohan Singh, succeeded in implementing a major round of reforms in the early 1990s. These reforms put India on a higher and more dynamic growth path.

Both countries have the size and potential to become major economic, security, and foreign policy powers. But they each face similar challenges including: internal regional economic development differences; ethnic, religious, and language tensions, and related pressures for self-determination; counterproductive government intervention at all levels; and pressures for political reforms. Each country also may have to adjust to a significant deterioration in a relatively positive global economic environment. Finally, major economic and political transitions contain their own seeds of instability. Thus, each country may experience internal crises that periodically undermine reforms and progress.

I expect both countries will watch how the other deals with such problems and also draw on the experiences of other countries facing similar problems. Of course sometimes countries follow the wrong examples or continue to repeat the same mistakes, for example Argentina and Venezuela. But I expect India and China to continue to learn from the successes and failures of others and succeed in implementing what works for each country. Thus I remain positive on the outlook for both countries. ◆