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Speech on “China and India – Future Leaders of the World Economy”

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As the 21st century unfolds itself before us economic predictions have become a devalued game. Economists had failed to predict the global meltdown. Economists are still confused about the process of recovery or the period over which recovery will take place. Economists are still recovering from the surprise at how quickly the Asian economies have withstood the global pressures created by the meltdown and predictably economists around the world are today very careful about what predictions they make.

While caution is the hallmark of economic predictions, such reticence is not to be found in one set of predictions. The world today is unanimous that China, India and to some extent Brazil are the economic superpowers of the 21st century. Economists are also very clear that the Asian nations as a whole will play a leading role in economics of the 21st century.

While such predictions would have been dismissed as absurd thirty years back, a keen student of history would probably conclude that the rise of the Asian giants was only inevitable. The Asian economies always had some strong fundamentals. Their habits of thrift and frugality, the high savings and investment rates and the work ethos were always there. What was lacking was the spirit of entrepreneurship. What was lacking was possibly self-belief and greater exposure to the world. The developed Western countries possess these qualities in abundant measure and, therefore, justifiably had become the leaders of the world economy. But with the reforms in Asia, with the spread of education, with increasing abilities to assimilate technology, the spirit of entrepreneurship has been unleashed in Asia and, therefore, the growth rates – especially in India and China are exhilarating and sustainable. If the momentum can

be maintained by the Asian economies and specially by China and India, there is no doubt that future world economy leadership is theirs for the asking.

Let us now turn to a few facts before I continue on this theme.

The People's Republic of China is the world's second largest economy after the United States by both nominal GDP (\$4.99 trillion in 2009) and by purchasing power parity (\$8.77 trillion in 2009). China is the world's fastest-growing major economy, with average growth rates of 10% for the past 30 years. China is also the second largest trading nation in the world and the largest exporter and second largest importer of goods.

In the modern era, China's influence in the world economy was minimal until the late 1980s. At that time, economic reforms initiated after 1978 began to generate steady growth in investment, consumption and standards of living. Since 1978 hundreds of millions have been lifted out of poverty: According to China's official statistics, the poverty rate fell from 53% in 1981 to 2.5% in 2005.

China has implemented reforms in a gradualist fashion. As its role in world trade has steadily grown, its importance to the international economy has also increased apace. China's foreign trade has grown faster than its GDP for the past 25 years. China's growth is driven both by huge state investment in infrastructure and heavy industry and from private sector expansion in industry. The smaller but highly concentrated public sector, dominated by over hundred large State Owned Enterprises, provided major thrust in areas such as utilities, heavy industries, and energy resources and played a key role in facilitating private sector growth.

Foreign investment remains a strong element in China's rapid economic growth and has been an important factor in the growth of urban jobs. From 1993 to 2001, China was the world's second-largest recipient of foreign direct investment after the United States. Annual inflows of foreign direct investment rose to \$ 108 billion in 2008.

In addition, by the end of September 2008 China replaced Japan for the first time as the largest foreign holder of US treasury securities with a total of \$585 billion, vs.

Japan \$573 billion. China's foreign exchange reserves and now the largest in the world exceeding \$ 2 billion.

Let me now turn to India and share some facts. India's entry to the global economic front ranks is even later than China's. Though history reveals that from 1 A.D. to the end of the 16th century, India was the world's largest economy, its share in world trade being higher than that of whole of Europe, from the beginning of the 17th century, India went into economic decline and was overtaken first by U.K. and China and then by many other countries. However, the story now is quite different.

The economy of India is the eleventh largest economy in the world by nominal GDP and the fourth largest by purchasing power parity (PPP). Triggered by economic reforms which started in the 1990s, India began to register fast economic growth. Growth rates have averaged to over 7% during the last two decades, just falling short of double digit growth in the best years. According to the BRIC report, published by Goldman Sachs, India will be the second largest economy after China in the next three decades.

India's large service industry accounts for 55% of the country's Gross Domestic Product (GDP) while the industrial and agricultural sector contribute 28% and 17% respectively. Agriculture is the predominant occupation in India, accounting for about 52% of employment.

While both India and China are aspiring to be world leaders, one must understand that their strengths lie in different directions. China, to a great extent, is a monolith. Much of its strengths come from state intervention and policy measures which are implemented with state support. Dams get built, roads get constructed and railway lines are laid with a single-minded sense of purpose. China's strengths are also in mass manufacturing. Its ability to manufacture products at low costs never ceases to surprise. China is also using its large foreign exchange reserves and economic muscle to control resources around the world. It is acquiring mines, oilfields, gas reserves and making strategic investments which will compliment China's own resource base.

India's growth is a study in contrast. The Government policies are slow and hindered by dissension. India's democracy believes in creating consensus before it moves

forward and therefore Govt. initiatives are often slow to take off. A newcomer to India apparently sees chaos everywhere and misses China's concerted unidirectional efforts. But that is a misleading impression and India's apparent anarchy delivers surprising effective results. India's strengths come from a growing band of entrepreneurs. These entrepreneurs have now built the world's largest steel company. These entrepreneurs have now built the world's lowest cost steel manufacturer. These entrepreneurs are offering air flights at \$ 50 and uninterrupted cell phone service at less than 1 cent per minute. These entrepreneurs are offering cars at \$ 2,200 and cardiac operations by top surgeons at a fraction of U.S. costs. The ability to innovate and experiment has also driven the Indian services industry to global leadership. Research and development centres on subjects ranging from bio-chemistry, space science, software platforms and multimedia features for next generation devices are coming up everywhere in India. Indian engineering houses use 3D computer simulations to design everything from car engines and forklifts to aircraft wings for global clients. In every phone made by Motorola around the world 40% of the software comes from India. As a spokesman for CISCO said – "We came to India for the costs, we stayed for the quality and we are now investing for the innovation".

While these differences account for the different models of growth, what cannot be overlooked is the large domestic market in both countries. China's passenger car market is shaping up to be the largest in the world. China has the world's biggest base of cell phone subscribers and the largest number of homes connected to broadband. India has a middle class and upper middle class numbering over 300 million, which is displaying very strong demand patterns for homes, for cars, for consumer goods and for services such as telephony, banking services, health care and education. India today has more credit card holders than the whole of Europe and a very large number of investors in its organized capital markets.

According to studies by Morgan Stanley, India's growth will start to outpace China's within 3 – 5 years and for the next 20 – 25 years India will grow faster than any other large country. McKinsey & Co. has predicted that India's economy will grow 5 fold in the next 20 years and the urban population will double from the 2001 figure of 290 million to 590 million by 2030.

Friends, I think I have thrown enough statistics at you and one does not need more convincing about the explosive growth that is today the reality in China and has been unleashed in India. India and China have become prime investment destinations, China more for foreign direct investments and India both for foreign direct investment and portfolio investment by institutional investors.

Let me conclude by talking a little of India as an investment destination. India hardly used to get \$ 2-3 billion as foreign direct investment when the process of the liberalisation economy started in the 1990s. Today's figures hover around the \$ 50 billion mark. India expects to invest \$ 500 billion in infrastructure within the next 3 years and only this need will send the FDI figure soaring over the coming years. India's weightage in the Morgan Stanley Capital International (MSCI) emerging markets index has increased to 11.5% in 2010 compared to 4.25% in 2002. During 2009-10 the net inflow of fund to India from foreign institutional investors was over \$ 29 billion. This figure will go up sharply during 2010-11 because of the surging stock markets and the extremely positive economic outlook.

Over the years the restrictions on foreign investment have been gradually eased in India and today except for a few areas of strategic importance foreign companies can invest in India up to 100% shareholding in most sectors. Earlier restrictions on foreign investment in sectors such as real estate and retail have been relaxed and the Govt. is walking the extra step to welcome investment in the infrastructure sector. Another sector in which policy guidelines are being liberalized and will be prime destination for foreign investment is education. India has a young population and the education needs are many. Foreign universities are being invited to set up campuses in the new liberalized education policy.

India's attractiveness as a FDI destination is also because of favourable enabling conditions. Indian laws are mostly patterned on British laws and are understood and interpreted easily across borders. The judicial system is also modelled on the British system and is transparent to a great extent. The Central and the State Governments are trying very hard to reduce the rigors of bureaucracy and to make the regulatory regime more business friendly. Its biggest strength, however, is that it is a vigorous functioning and stable democracy and Govt. power is always kept under checks and balances. India has also launched a most ambitious tax reform initiative which will

bring down the incidence of both direct and indirect taxes. Major reforms in indirect tax will also reduce the multiplicity of taxes. India's familiarity with the English language, the ease of communication, a transparent democratic process, freedom of the media, consumer protection laws and the business friendly Governments across the nation makes India today the prime destination for global capital.

Friends, the China-India growth story will be a continuing one and I do hope that all of us and especially the GGI group across the world will be players in this saga and not mere spectators.