

## ANALYSIS

## Economies of China, India challenge U.S.

'Chindia' could pass America in 30 years

Home to almost one-third of all humanity, India and China are two of the world's fastest-growing economies. For the past 20 years China has grown at more than 9 percent while India has grown at more than 6 percent per year, becoming



Bento Lobo

the second- and fourth-largest economies in the world, respectively. By 2030, the two giants could account for half of global output of goods and services.

In the last quarter century, China has made strides in reforming a centrally planned system to a market-oriented economy.

The biggest changes are seen in the opening up of the economy to foreign trade and investment, the phasing out of collectivized agriculture and the gradual liberalization of prices. Today, China has a space-age skyline, some of the world's biggest industrial zones, dozens of research centers and a bullet train. Its highway network stretches for about 870,000 miles. Per capita income has tripled from 1990 levels. Three million fewer people live in poverty than did in the 1980s.

Investment is booming because China is awash with cheap money from its record trade surplus, which climbed in 2005 to \$102 billion.

#### A GIANT STIRS

India is home to one of the oldest civilizations, dating back more than 5,000 years. With more than 1 billion people, India is, after China, the second most populous country, and the seventh-largest country by geographical area.

The rapid economic growth of the last two decades might not be immediately evident to foreign observers. Signs of poverty are everywhere. Beggars greet you as you step out of the Mumbai International Airport.

A closer look, however, reveals new office buildings, research and development centers, a thriving private sector, a vibrant entrepreneurial spirit, and an optimistic outlook. Indian stock prices have skyrocketed even as the National Stock Exchange and the Bombay Stock Exchange rank third and fifth in the world by number of transactions.

#### SHADES OF GROWTH

How can the largest communist state in the world and the world's largest democracy achieve such eye-popping economic growth?

India and China are predominantly poor geographic neighbors. Yet each is growing at rapid rates by following strikingly different economic models.

China is strong in hardware while India is strong in software. China is stronger in physical markets while India is stronger in financial markets.

China's growth has stemmed from labor-intensive, small-scale rural industry exports. India's growth has been more knowledge-intensive, tapping on cheap brainpower rather than cheap labor.

With labor often priced at 50 cents an hour, China is the leader in mass manufacturing and multibillion-dollar electronics and industrial plants. India is the leader in software, design, services and the precision industry.

China directs massive investment into public works and factories now account for more than 50 percent of the country's economic growth, more than any other country.

India, by contrast, receives less than 10 percent of the foreign direct investment that China does.

However, annual foreign portfolio flows into the capital markets have averaged \$1.5 billion in the past five years as investment bankers scramble to find a home in India.



THE ASSOCIATED PRESS

Ships are under construction in Shanghai, China. China's sizzling economy will grow 9.5 percent this year, the World Bank said in a forecast, up from its earlier figure of 9.2 percent. China, the world's third-largest shipbuilder, has been eager to cash in on a global boom in shipping that has largely been a result of its own surging exports and demand for raw materials.

#### SOCIALISM WITH BEAUTY SPOTS

The economic divide in China is quite pronounced. The coastal and southeast regions are thriving centers of trade that benefit from a controlled exchange rate policy. State-owned enterprises run the rest of the country based on a centrally planned economy. These government companies are inefficient, money-losing entities that feed on government resources and four primary banks that channel local deposits to these enterprises.

Outside the major cities, over 150 million people are jobless.

Almost 60 percent of Chinese exports come from foreign-owned factories. The massive foreign investment that China takes in, almost \$60 billion in 2005 alone, could be showing up the deficiencies of its own corporate sector. The cumulative effect is that Chinese firms are less competitive than they would be otherwise.

#### CAPITALISM WITH WARTS

Shedding a post-British legacy of a confused "mixed economy" ideology based on heavy industry and agriculture, India has put major market liberalization reforms in place in the last couple of decades. This has fostered genuine entrepreneurship, which along with a modern stock market and private banks, have made the country far more capital-efficient than China.

Ironically, democratic traditions are among the biggest impediments to growth in India. The ruling coalition in this parliamentary democracy involves more than 20 parties, hampering decision making and rapid socio-political reform. The nearly 3 million elected officials and coalition governments at the federal and state levels complicate the division of power in a system where many political actors wield a veto.

Rigid labor laws and foreign investment restrictions also limit growth in India. Critics also point to India's inadequate transportation, telecommunications and utilities as impediments to growth.

The World Bank estimates that 35 percent of Indians live on less than a \$1 a day.

#### THE COSTS OF GROWTH

China's long-standing "one child" policy has been successful at controlling population growth, but China's rapidly aging population has led economists to predict a crisis of sorts: In 15 to 20 years China will have more than 300 million people over age 60 and only one in six Chinese workers has a pension.

Moreover, half the country's investment is plowed mostly into already full-capacity sectors such as crude steel, vehicles and office buildings. Chinese factories burn fuel five times less efficiently than in the West. Six of the top 10 most polluted cities in the world are in China and the World Bank estimates that pollution costs China more than \$54 billion a year.

Bureaucratic red tape and corruption in India are legendary. Starting a business requires



ENCA/GETTY IMAGES

President George W. Bush shakes hands with free market-oriented Indian Prime Minister Manmohan Singh in the White House in July 2005.

10 permits and a median time of 90 days in India, about twice as long as in China.

#### OUTSOURCING U.S. JOBS

Chinese merchandise fills our store shelves. In 2005, China sold \$202 billion more products in the United States than the United States sold in China, accounting for more than a quarter of a record U.S. trade deficit of \$726 billion.

Some are apt to blame the Chinese for the growing trade deficit and the loss of American jobs. Often lost in the discussion, however, is that up to 8 million U.S. jobs now depend

on Chinese trade. Moreover, 10 of China's top 40 exporters are U.S. companies with local factories. Many of these make products that stretch U.S. paychecks because they are sold at the "always low prices" at Wal-Mart. In fact, China's seventh-largest trading partner is Wal-Mart.

There is a good chance that a routine credit card or PC-related customer service call will be answered in Bangalore or Hyderabad in India. The outsourcing/offshoring juggernaut has met with resistance from political and labor lobbies. In 2005, Tennessee became the

first state to provide preferential treatment to companies to keep jobs at home.

India's "go to" status as the premier outsourcing destination is built on the country's vast pool of about 2.5 million mostly English-speaking graduates, earning on average \$50 a week.

However, there might be more to it than just cheap brainpower. A Cisco senior executive had this to say: "We came to India for the costs, we stayed for the quality, and we're now investing for the innovation."

#### U.S. MAY BE SURPASSED

Pundits predict that within 30 years, China is expected to replace the United States as the world's largest economy, while India is expected to replace Germany as the world's third-largest economy.

China's state-controlled economy makes it easier to mobilize labor, clear out land, build infrastructure and restrict wages. However, quality of life issues manifest in the restrictions on Internet access, the quashing of political opposition and the brewing of social unrest make the sustainability of this growth model suspect.



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#### EDITOR'S NOTE

Dr. Bento Lobo, a University of Tennessee at Chattanooga associate professor of finance, prepared this report based on the essays by international finance students Jeanne Hinchee, Megan Prichard, Jonathan Sharp and Emily Uplain.

The Beijing Olympic Games in 2008 could provide the world with a ringside view of things to come.

As for India, predicting economic outcomes is difficult in an ancient culture that has supported arranged marriages and the dowry system, the simultaneous abuse and worship of women, and a caste system, now illegal to practice, that assigned occupations and social roles to people based on hereditary social stratifications.

However, in attaining a comparatively more mature level of political development, India has solved the biggest long-term challenge facing China. Indian democracy faces no threat from globalization but China's system of governance is likely to change in the not-too-distant future.

The yin and yang of these immense work forces are already converging. Thanks to the Internet and plunging telecom costs, multinationals are building goods in China with software and circuitry designed in India. The distance between India's low-cost laboratories and China's low-cost factories shrinks by the month. Indeed, the neologism "Chindia" is already widely in use.

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