Economist/Chatham House debate

India will overtake China in the next 25 years

I thank the Economist for inviting me to this forum. Ten years ago, it was unthinkable to compare China with India. The emergence of India and China as major global players heralds new realities. Both countries have transformed the global political architecture increasingly shifting power from West to the East. The question issue here is the nature of the India's economic growth and its potentials to outperform China.

To-day India has become the world's most debating chamber before economists and entrepreneurs like you, it is not without a reason – it is an exiting love-affair with growing passion which reminds us all that rise of India means that democracy can be good for growth. It also poses a question that can an Indian political model based on democracy and rule of law can overtake rival Chinese political model of unbridled government authority as a formula for making poor countries rich.

India's economic dynamism constitutes a huge paradox comprising achievements and failures simultaneously. Economic reforms in India over the last few years in particular are promising but not sufficient. India may claim that there is no other country in the world which is so productive and that India's pluralistic system is in fact strength rather than a weakness, it is not too convincing given the slow pace of development. India may claim that because of the democratic system it has fallen behind China in terms of both FDI and growth rates, but in fact a lot of problems being experienced in India are not because of democracy but because of bureaucracy, controls and restraints in establishing enterprise and barriers in the way of entrepreneurship and lack of effective governance.

Two years ago the view that India might have a more competitive economy than China was met with incredulity. To-day comparison of the two countries offers valuable insights for us for the global economy. A fundamental distinction is that China's growth stems from resource accumulation while India's is rooted in increasing efficiency.

China's rise was due to major investment in infrastructure, when economic liberalization and institutional reforms deserve more credit. China pursued this goal while giving less priority to education. India's educational system, on the other hand, has steadily improved, especially in rural areas.

China faces several challenges, such as corruption, fragile financial system, unemployment, energy security, environment degradation, likely shrinking of the FDI, failure to create enough jobs which is already triggering unrest, its aging society beginning in the 2020 and it is very unlikely that China would be able to place pension and health care system and if by any means the economy takes the down trend it would have devastating affect of political instability, HIV/AIDS and most importantly the Taiwan conflicts. China’s emergence could be severely dented if it faces crisis of confidence.

The same rule of law that allowed China to bulldoze homes for skyscrapers, for example, has also led to corruption, rising inequality and social unrest. Conversely, India's apparent weaknesses - a cumbersome democracy, lack of central planning and unrestrained population growth - could be long-term advantages.

China's economic superpower ambition has flaws, including graft and waste. India, in contrast, enjoys many hidden, long-term advantages. Although India's literacy rate is much lower than China's, its technical and management institutes are far better than such schools in China. It is estimated that that only 10 per cent of Chinese engineers have the skills required to work in a global company, while the comparable number for India is 25 per cent.

Moreover, the massive flows of foreign investment into China are a two-edged sword. It has become a substitute for domestic entrepreneurship. Few of the Chinese goods are in fact made by indigenous companies. And the few that exist are besieged by regulatory constraints and find it hard to raise domestic capital. China's state-owned enterprises remain massive but bloated and possess a frightening number of nonperforming loans from China's vulnerable banking system.

China's export-led manufacturing boom is largely a creation of foreign direct investment (FDI), which effectively serves as a substitute for domestic entrepreneurship. During the last 20 years, the Chinese economy has taken off, only few local firms have been developed as world class companies to rival the big multinationals.

On the other hand, India has managed to spawn a number of companies that now compete internationally with the best that Europe and the United States have to offer.

India too faces these challenges that China faces, some challenges are even greater than one can imagine. Corruption is a major issue. However, India is well positioned to tackle these issues through participatory process whereas China can not. Even though India's democratic system can be cumbersome and slow, it is stable, which makes investment less risky than in an opaque, authoritarian environment.

India's banking and financial institutions are well established and have long been lending on the basis of market-based analysis, which helps explain their more efficient use of capital.

Among the other advantages India has is that the common language of Indians is English, which makes it easier for the country to fit into an international business system.

China faces shrinking workforce due to its one child policy. China's working population will peak at 1 billion by 2025 and then shrink steadily and that providing retiring benefits would be a major problem. On the other hand India will have 1.6 billion population - 220 million more than China. Indians with half its population under 25 years means that the country will have no problem paying for elders' future health care and pension costs.

India has grown steadily at an average 6 per cent since the country embraced market economy. Last two years have been eventful with more than 8 per cent of growth. While India has an economy that is growing from the grassroots, China's economy's roots are not set from the individual up but from the government down. China's economy is not demand driven but performance/producers under strict guidance set down by the government. Foreign investors have looked China for term opportunity where political and internal unrest can wipe out gains at one blow. India on the other hand offers long-term possibilities for growth, even though the returns may not be that huge in the short term.

India’s population is just 200 million short of China’s 1.4 billion, nevertheless, India’s medium age is just above 24 years while that of china is into thirties.

In the last decade, India has emerged next to China in their growth rate. Empowered by engine from IT, and exporting its manpower throughout the world that has increased the credibility of India, and made it an economic powerhouse for the 21st Century; and it has shown that it has all the guts to be in that ceremonious position.

India is world leader in IT Services and BPO off-sourcing with 65% and 46 % share of the global pie. The World off-shoring market currently is valued at $300 billion, of which $110 billion will be off-shored by 2010 and India has the potential to capture 50% of it employing up to 8.8 million people.

The Indian BPO industry has grown at a mind-boggling 60–70 percent annually, with revenues rising from US$565 million in 1999–2000 to more than $3.4 billion now - China's was only a fraction of it - $210 million.

With huge investments flowing into China and with robust domestic demand, it's a paradox of plenty as far as China is concerned. The higher you go, the harder you will fall. Policy makers in China seem to understand this well as they have taken deliberate measures to slowdown the surging economy.

India is better placed than China for future growth. Its capital markets operate with greater efficiency. They are also much more transparent. Companies can raise the money they need. India's legal system, while too slow, is much more advanced and is able to settle sophisticated and complex cases. Its banking system has relatively few nonperforming assets.

India's democracy and news media are alive and vital, which provides a safety valve for the incoherent changes that modern economic growth brings. India has religious riots, secessionist movements, urban squalor and bitter rural poverty. But the voters know they can throw the rascals out, and they regularly do.

For decades China has benefited from the wealth and the investment potential of its Diaspora and the economic energy of Hong Kong and Taiwan. After years of ignoring its Diaspora, India is now welcoming them back - and they have much more "intellectual capital" to offer than China's. The remittance inflow from overseas Indians during 2005 was more than 21 billion dollar, much more than Chinese Diaspora has remitted.

India seems all set to outperform China in the next 20 years. But, hopefully, the biggest beneficiary of the rise of India will be China itself. It will be forced to examine the imperfections of its own economic model and to abandon its sense of complacency acquired in the 1990s. China was years ahead of India in economic liberalisation. Today it lags behind in critical aspects, such as reform that would permit more foreign investment and domestic private entry in the financial sector.

In the long run, India will overtake China in economic growth owing to home-grown entrepreneurship, stronger infrastructure to support private enterprise and companies which compete internationally with global firms, a media report has claimed.

The real issue is not where China and India are today but where they will be tomorrow. The answer will be determined in large measure by how well both countries utilize their resources, and on this score, India seems to be doing a better job.

The danger for both China and India, however is that the race to the top will create such huge income disparities in both countries which will lead to revolution in China and riots in India. It is not surprising that China is taking active measures to channel some of its huge financial reserves into the rural areas. India too is addressing the issue aggressively.

India has also developed much stronger infrastructure to support private enterprise. Its capital markets operate with greater efficiency and transparency. Its legal system, while not without substantial flaws, is considerably more advanced.

Indian policy makers have an opportunity to change India, fortune of its 1.2 billion people. Both India and China are cruising through eight lane super highways. The Chine superhighways are paved well with side walks but it has lots of political bumps and pot holes ahead of it whereas the road for India looks smooth but with several challenges. With foundations of reforms in place and the dreams of all Indians to beat all in this race, I am convinced that India will eventually overtake China.

The international system is changing towards an age where human and trade union rights will be an important currency of power. Military and economic might alone would not do. Although China has 450 million people in its globalized economy compared to India's 250 million, the participation of Chinese workers in the economic progress is limited only to "production" without any rights. Chinese workers are denied their basic trade union rights. China does not respect internationally recognized core labour standards.

India finds its strength in democracy whereas China believes in imposing laws. In fact, to those who doubt the universal application of democracy and its economic virtues, I say that in spite of India's sizeable challenges it faces, it is a remarkable example of what democracy can achieve. Lastly, in my view one of the important reasons for India having an edge over

China is the lack of democracy and one party rule in China.

The paper was presented by Sunil Prasad, Secretary General, Europe India Chamber of Commerce (EICC) and President, Global Organization of People of Indian Origin (GOPIO) in the Debate sponsored by The Economist in association with The Royal Institute of International Affairs, London on 2 March 2006.