



TWO PILLARS OF THE ASIAN ECONOMY

China and India will be the engines driving Asian economic growth this decade.

On the surface, China and India look similar in terms of growth prospects and investment opportunity. But underneath, the countries are different in terms of what may drive that growth, and what challenges each may face.

China and India are two real economies that cannot be ignored. If you look at a measure of GDP growth, the economies in China and India have grown on average 8.4% and 6.0% respectively over the past 10 years. There is no other country that compares to this today, or as you look out over the next three to four years.

To put this in perspective, these two countries combined represent 48% of the Japanese economy, 20% of the U.S. economy and on purchasing power parity they represent 23% of the global economy—some very compelling figures.

In addition, almost 40% of the world's population is based in the two countries, which are populated by a young, highly educated, mobile, non-unionized labour force that is attractively priced. Reviewing demographic trends, by 2020 50% of India's population and 30% of China's population will be under 30 years of age.

Each country, however, has its own competitive advantages, opportunities and risks.

Competitive advantage

China is described as 'the factory of the world'. In fact, 20% of all global manufacturing today is in China. China is a cheaper alternative for manufacturing and has attracted more and more outsourcing from companies in major developed countries. In addition, over the past 20 years China has placed a strong emphasis on infrastructure development that has opened up its economy and helped attract an increasing amount of foreign direct investment.

India, in comparison, has a competitive advantage in information technology outsourcing. This has occurred not only because of relatively lower labour costs, but also because of a highly educated and well-trained workforce. India is an English-speaking population,

which is significant for doing business globally. Over 900,000 engineers graduate from colleges in India every year—unmatched by any other country.

Risks

The largest risk in China remains inefficiently allocated capital resources. There is essentially no 'cost of capital' in China today because the government determines which sector should be the beneficiary. This inefficient use of capital has created inequities in the system. In addition, China has a fragile financial system and needs further tax and agricultural reform.

In India, the largest risk is the bureaucracy—as an investor, you worry about political interference and you worry about a political agenda that is 'non-capital' in nature.

Other obstacles include the high cost of capital and a poor infrastructure that needs attention in order for India reach growth expectations.

Investable opportunities

China has a large stock market but the majority of the companies are government-run and inefficiently operated without any accounting standards. There are, however, many indirect investment opportunities that benefit from China's growth: these are companies that are listed outside China that adhere to accounting standards and principles, and companies that are managed with the shareholder's interests in mind.

India, by comparison, has a very deep public market, strong corporate governance, and Western accounting standards. The Indian stock market is 110 years old, which exemplifies its accountability to all shareholders to provide investors with opportunities.

Both the markets in China and India provide their own unique opportunities and risks that one must clearly be aware of because there is a definite price of capital and a cost of failure. However, the real cost of failure is not paying enough attention to these markets. ■

PREM MANJOORAN

Vice-president, Capital International Research, for Capital Guardian.