
China and India: A Tale of Two Giants

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Back to the Future?
What Was, What Is.....

Source: McKinsey (based on data from German economic historian Angus Maddison)

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.....Where Things Might Be Headed?

Global Ranking by GDP

2010 | 2015 | 2020 | 2025
---|---|---|---
China | 2 | 2 | 1
India | 9 | 7 | 3

Data & Analysis: IMF & China India Institute

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GDP Growth Rates (%)

Data: IMF

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The New Normal for China?
How Fast Is China Actually Growing?
Change in economic expansion from a year earlier

- China’s official GDP estimate
- Li Index: A measure that averages the annual growth rates of electricity output, rail freight, and real credit

The Hunt for China’s Real Growth Numbers
- Economists using a “Li Index” find GDP growth is 5 percent
- The “official numbers go through a smoothing process”

Bloomberg Businessweek, March 9, 2015
China’s Challenge

% of GDP

Gross Fixed Capital Formation

46.7

34.1

34.1

15.8

14.1

Data: World Bank

Government Consumption

Net Exports


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Debt Binge

Debt As % of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Debt</th>
<th>Government</th>
<th>Financial Institutions</th>
<th>Non-Financial Corporate</th>
<th>Household</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>$2.1t</td>
<td>121</td>
<td>8</td>
<td>83</td>
<td>7</td>
</tr>
<tr>
<td>2007</td>
<td>$7.4t</td>
<td>158</td>
<td>20</td>
<td>72</td>
<td>24</td>
</tr>
<tr>
<td>2Q14</td>
<td>$28.2t</td>
<td>282</td>
<td>38</td>
<td>125</td>
<td>65</td>
</tr>
</tbody>
</table>

Source: McKinsey Global Institute

Anil K. Gupta, *A Tale of Two Giants: China and India*. May 2015. All rights reserved.
Overinvestment in Real Estate?

New construction of gross floor area by tier

Index: 100 = 2000

Source: McKinsey Global Institute

% CAGR
2008-2013

- Tier 1 cities: 228, 17.9%
- Tier 2 cities: 171, 11.3%
- Tier 3 cities: 139, 8.9%

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Urbanization Trends

Capex next 25m units of housing < capex last 25m units

20%  
50%  
75%

Deceleration  
Acceleration

1980  
2010  
2040

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Auto Sector

Passenger Vehicles Sales (m)

Data: www.oica.net; China India Institute analysis

China Sales 2040 = 55m (at peak)
China Sales 2030 = 40m (estimate)
→ CAGR 2014-2030 = 5.0%

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Demographics

### Labor Pool (m)

<table>
<thead>
<tr>
<th>Year</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>756</td>
</tr>
<tr>
<td>2010</td>
<td>971</td>
</tr>
<tr>
<td>2030</td>
<td>960</td>
</tr>
</tbody>
</table>

### Median Age (yrs)

<table>
<thead>
<tr>
<th>Year</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>25.1</td>
</tr>
<tr>
<td>2010</td>
<td>34.5</td>
</tr>
<tr>
<td>2030</td>
<td>42.5</td>
</tr>
</tbody>
</table>

### Old Age Dependency Ratio (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>9.0</td>
</tr>
<tr>
<td>2010</td>
<td>11.3</td>
</tr>
<tr>
<td>2030</td>
<td>23.9</td>
</tr>
</tbody>
</table>

Data: UN Population Division

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• 75% of electricity production from coal

• Air, water and land pollution is now the #1 concern of Chinese citizens → ahead of corruption or economic growth

• Being viewed very seriously by senior leadership

• However, serious governance challenges → actions << goals

Anil K. Gupta, *A Tale of Two Giants: China and India*. May 2015. All rights reserved.
China SOE’s restructuring leaves state ownership intact

Gabriel Wildau in Shanghai

Shanghai Electric Group became the latest Chinese company to answer the call for reform of inefficient state-owned enterprises as it announced a restructuring that would see it acquire assets from its state parent.

The company, one of China’s largest electrical equipment producers, will transfer the assets from its unlisted parent into its listed subsidiary — a proposal that matches last year’s restructuring at Citic Group, one of China’s largest SOEs. Despite being listed in Hong Kong and Shanghai, Shanghai Electric is 63 per cent state owned.
One Belt, One Road

- Conceptually sound
- But long gestation
- Who pays? Who owns? What returns?
- Driven by SOEs’ self-interest?
- Geopolitics – Opportunities vs. constraints

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Yuan Globalization

- CNY moving closer to market valuation
- High likelihood of becoming freely convertible by 2020
- High likelihood of relaxation of controls over capital flows
- On the road to becoming a global reserve currency
- But will take time to build global clout

Global role – USD vs. CNY

Source: WSJ, April 16, 2015

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Escape “Middle Income Trap”?

• High probability -- but slower escape velocity than earlier expectations

• Can consumption growth compensate for investment slowdown? Only partially.

• Key requirement: INNOVATION
  + Heavy spending on R&D (#2 in world)
  + Strong education system (esp. STEM)
  + Widespread consensus re innovation imperative
  + Large pool of venture capital (domestic + foreign)
  + Growing pool of alumni from new tech powerhouses (Alibaba, Baidu…)
  ? Strong IPR laws but weak enforcement
  ? Growing hostility towards Western tech companies
  ? Patents: passion for quantity >> quality
  ? Rote learning + hierarchical society
  ? SOE reforms: rhetoric >> reality (also, pace of political reforms?)

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India – The Modi Difference?
Annual GDP Growth (%)

Result of Earlier Reforms

Global Financial Crisis

Rapid Recovery

Then Collapse

Will the uptick last?

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Explaining the Recent Malaise

- Complacency & lack of reform
- Too many handouts → Budget deficits
- Weak coalition-based government
- Corruption, corruption, corruption!
- Political and bureaucratic paralysis
- High oil prices → Rising trade deficit
- High inflation → High interest rates → Declining investment
- US Fed signals end of easy money

Manmohan Singh
India’s PM 2004-2014

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India’s Structural Problem: Weakness in Manufacturing

<table>
<thead>
<tr>
<th>Agriculture</th>
<th>Manufacturing</th>
<th>Other Industry</th>
<th>% of GDP (2013)</th>
</tr>
</thead>
<tbody>
<tr>
<td>18.2</td>
<td>12.9</td>
<td>11.9</td>
<td>57.0</td>
</tr>
<tr>
<td>Services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10.0</td>
<td>31.8</td>
<td>12.1</td>
<td>46.1</td>
</tr>
</tbody>
</table>

Data: World Bank

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Infrastructure Investments

China has overtaken the United States and the European Union to become the world's largest investor in infrastructure.

Amount spent on infrastructure, 1992–2011
Weighted average % of GDP

Source: McKinsey Global Institute, 2013

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1. Retain the brilliant and strong-willed central bank governor

2. Commitment to fiscal consolidation (e.g., cuts fuel subsidies)

3. Raise FDI caps in insurance and defense to 49% and rail sector to 100%

4. Target roll-out of “National GST” by April 2016

5. Aggressively streamline political and bureaucratic machinery

Key Moves to Date – 2

7. Launch “Make in India” campaign

8. Court neighbors (Nepal, Bhutan, Bangladesh, Sri Lanka, Pakistan) to enhance stability

9. Court the G-3 (US, China, Japan) to attract FDI

10. Launch “Clean India” campaign

11. Launch “Digital India” and “Smart Cities” campaign

12. Aggressive moves towards financial inclusion → 100m new bank accounts in last 6 months
“Make in India” Campaign

- Centerpiece of Modi’s policy agenda
- Modi acting as an avid salesman
- Initial focus areas:
  - Defense (US, Russia, Japan, France, Germany….)
  - Rail (Japan, China)
  - Automotive (GM, Ford, Hyundai, VW….)
  - Consumer electronics (Foxconn, Microsoft, Lenovo….)
Key Policy Challenges

• Land acquisition bill
  ➢ Remains a serious challenge
  ➢ 30% probability

• National Goods and Services tax (to replace state-level levies)
  ➢ Very good chance of happening by 4/2016
  ➢ 75% probability

• “Tax terrorism” – 3 steps forward, 1 step back
  ➢ Modi government means well
  ➢ Clarity going forward
  ➢ But missteps regarding legacy issues (esp. “Minimum Alternative Tax” on foreign institutional investors)
Demographic Dividend?

Median Age – 2010 (yrs)

<table>
<thead>
<tr>
<th>Country</th>
<th>Median Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>44.7</td>
</tr>
<tr>
<td>Germany</td>
<td>44.3</td>
</tr>
<tr>
<td>France</td>
<td>39.9</td>
</tr>
<tr>
<td>USA</td>
<td>36.9</td>
</tr>
<tr>
<td>Russia</td>
<td>37.9</td>
</tr>
<tr>
<td>China</td>
<td>34.5</td>
</tr>
<tr>
<td>Brazil</td>
<td>29.1</td>
</tr>
<tr>
<td>SE Asia</td>
<td>27.5</td>
</tr>
<tr>
<td>India</td>
<td>25.1</td>
</tr>
<tr>
<td>Africa</td>
<td>19.7</td>
</tr>
</tbody>
</table>

Source: UN Population Division

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Technological Strength

Key Enabler of Making India a Global R&D and Manufacturing Hub

- Only Asian country to have successfully put a satellite into Mars orbit ($79m budget)
- And, to have done so on the first attempt
- Along with China, one of the two most active new destinations for R&D labs of western MNCs
- Strong higher education system (IITs + IIMs) plus large numbers

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The 13-Year Divide: India's Economy Looks Much Like China's in 2001
Delhi Hopes to Emulate Beijing's Success, but Will Delay in Liberalizing Prove Too Costly?

Closing the Gap
Economic liberalization began earlier for China than for India, but both took off on similar paths.

- **Gross domestic product per capita, adjusted for inflation**
  - China: $3,500 to $8,000
  - India: $1,500 to $4,000

- **Exports of goods and services, as a percentage of GDP**
  - China: 40% to 60%
  - India: 15% to 30%

- **Stock of foreign direct investment, as a percentage of GDP**
  - China: 25% to 35%
  - India: 10% to 20%

- **Domestic investment in equipment, infrastructure and other physical capital, as a percentage of GDP**
  - China: 50% to 60%
  - India: 30% to 40%

Source: U.N. Conference on Trade and Development

The Wall Street Journal

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China-India: Growing Linkages
Harmony

War \rightarrow Cold Peace

Robust Trade (but unbalanced)

Trade \rightarrow Investment

1960

2000

2014

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Robust But Unbalanced Trade

Merchandise Trade (US$ billions)

Source: UNCTAD

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Direct Investments – The New Frontier

China → India >> India → China

- Industrial Parks/SEZs (via JVs?)
- High Speed Rail (CNR, CSR…?)
- Power Equipment (Shanghai Electric, TBEA….?)
- Solar PV (Trina Solar?)
- Construction Machinery (Sany?)
- Insurance (Fosun?)
- ICT (Huawei, ZTE, Lenovo, Xiaomi…..?)

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Xi Visits India – September 2014

India and China sign 12 agreements, one of which will see China investing $20bn (£12.2bn) in India's infrastructure over five years....

Under the investment plans, China pledged to:

• **Help bring India's ageing railway system railway system up-to-date** with high-speed links and upgraded railway stations.

• **Set up industrial parks** in Gujarat and Maharashtra.

• **Give more market access to India** to products, including pharmaceuticals and farm products.
A Complex Relationship

India, China Disputed Borders

WESTERN SECTOR: The Ailai Chai, a barren plateau that was part of the former princely state of Jammu and Kashmir, has been administered by the Chinese since the 1962 Sino-Indian border conflict. One of the main causes of that war was India’s discovery of a road China built through the region which India considered its territory.

EASTERN SECTOR: China claims portions of the Indian state of Arunachal Pradesh as South Tibet and does not recognize the McMahon Line established in 1914 by the British and Tibetan representatives. China withdrew its troops behind the McMahon Line (which it refers to as the Line of Actual Control) after the 1962 border war.

China protests Modi’s visit to disputed border region

Feb 20, 2015

MEDICINE SECTOR: Sikkim officially became an Indian state in 1975, following a people’s referendum. Prior to 1975, Sikkim had been a monarchy enjoying protectorate status from India. Chinese maps portray Sikkim as an independent country.
A Complex Relationship

Modi to go on a state visit to China - May 14-16, 2015

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Three Scenarios

The Good
- Permanent and peaceful resolution of border issues
- Rapid growth in economic ties

4-5% probability

The Not-So-Bad
- Status quo
- India-Japan ties >> India-China ties

95% probability

The Ugly
- India-Pakistan war (and China seen as supporting Pakistan)
- Or, India-China war
- Or, India forced to choose sides in event of war in East Asia

~ 1% probability

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Global chief executive officers should stop praying for a miracle in China. As the investment- and export-driven boom of the last 15 years comes to an end, the days of double-digit annual growth in gross domestic product are over. Depending on the pace and nature of economic and