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Why India Will Beat China

An entrenched and vibrant democracy will ultimately drive India to outperform China socially and economically

by [William Nobrega](#)

Authoritarian regimes often yield impressive short-term economic results, as seen in Germany in the 1930s, the Soviet Union in the 1950s, Brazil in the 1960s, and China in the 1990s. Unencumbered by such things as property rights, legal recourse, and public debate, the authoritarian regime can harness significant economic and political resources to create impressive industrial and economic feats.

Conversely, democratic regimes tend to be sloppy affairs with loud public discourse, a vocal press, stubborn land owners, and a myriad of civil liberties. Far from being able to harness economic resources, the government often must act more as a regulator. The result is that there are very few grandiose government-sponsored projects. Instead, there are countless private-sector initiatives driven by the invisible hand of the market. While the authoritarian regime is envied by some, the fact is that longer term, this type of socioeconomic model has typically led to economic and social distortions.

That is the dilemma that China faces today. Since the 1980s, the Chinese government has focused on developing an export-driven economy supported by an artificially undervalued currency. Foreign direct investment was encouraged while domestic consumption was limited. Massive infrastructure projects were initiated, fueled by a growing trade surplus, with cities sprouting up in the hinterlands like some mythical phoenix. For years, the Chinese economy benefited from these policies with double-digit gross domestic product growth, vast foreign currency reserves, and ever increasing capital inflows.

INFLATION COULD SPARK SOCIAL UNREST

But now the economic and social distortions have begun to appear with rising inflation rates, numerous asset bubbles, looming overcapacity, and rampant institutionalized corruption. The Chinese government finds itself in a quandary. If the government allows its currency to rapidly appreciate to reduce inflation it will drive down exports and fuel unemployment. If it fails to quell inflation, social unrest will quickly unfold.

But even if the hare is running into obstacles of its own design, how will it give India the competitive edge? The advantage comes in the form of an entrenched and vibrant democracy that will ultimately drive India to outperform China socially and economically. Messy, frustrating, and more often than not agonizingly slow, India's democracy would seem to be chaotic at the surface. But if you look deeper you will quickly see why the tortoise will win this race. Let's take a look at two of the major advantages that India's democracy provides:

- **Property Rights:** As India becomes urbanized many families will choose to sell or borrow against their land so that they can start businesses, buy apartments, or provide education opportunities for their children. India is at the beginning of a gradual migration that is being driven by the development of high-end manufacturing and other sunrise industries that will require a vast pool of semiskilled and skilled labor. This migration will create an increasingly urban India that is expected to attract more than 200 million rural inhabitants to urban centers by 2025, primarily in what are known as secondary or "B & C" cities.

This transition will facilitate the sale of land holdings by an estimated 30 million farmers and 170 million other individuals

indirectly tied to the agricultural sector. The sale of these holdings is expected to generate more than \$1 trillion in capital by 2025. This capital will have a multiplier effect on the Indian economy that could exceed \$3 trillion. The development of the mortgage-backed security and asset-backed security markets, driven by financial institutions like Citigroup ([C](#)), will create the liquidity required to free up this capital.

China, by contrast, has no rural property rights. China's 750 million rural residents who lease land are at the mercy of the local and regional government as to what compensation they will receive, if any, when they are forced from the land as a result of development, infrastructure improvements, etc. Additionally they have no right to borrow against their lease, and as such they have no assets. In fact, the Chinese government's official figures state that more than 200,000 hectares of rural land are taken from rural residents every year with little or no compensation. According to some estimates, between 1992 and 2005 20 million farmers were evicted from agriculture due to land acquisition, and between 1996 and 2005 more than 21% of arable land in China has been put to non-agriculture use.

The result is not unexpected, with over 87,000 mass incidents (or riots) reported in 2005, a 50% increase from 2003. Many provincial governments in China have begun to use plainclothes policemen to beat, intimidate, or otherwise subdue any peasant that dares to oppose these land grabs. And, as would be expected, the beneficiaries from these policies are developers and corrupt government officials.

- **Rule of Law:** The rule of law is a fundamental cornerstone of any modern society. India has a legal system that has been in place for well over 100 years. This legal system is internationally respected and includes laws that protect intellectual property as well as physical property. The rule of law creates predictability and stability that allows entrepreneurial behavior to flourish. This is clearly evident in India, with more than 6,000 companies listed in the stock exchanges, compared to approximately 2,000 in China. More telling is the fact that of the 6,000 listed companies in India only approximately 100 are state-owned. This stands in stark contrast to China, where more than 1,200 of the 2,000 companies listed on the exchanges are state-owned.

Can there be any doubt as to where the next Microsoft ([MSFT](#)) or Intel ([INTC](#)) will be created? Certainly not China!

More than 100 Indian companies that completed initial public offerings as midcap companies now have a market capitalization of over \$1 billion. Companies such as Jet Airways ([JET.BO](#)), [Bharti Tele-Ventures](#), Infosys Technologies ([INFY](#)), Reliance Communications ([RLCM.BO](#)), Tata Motors ([TTM](#)) (which just acquired Jaguar), Wipro Technologies ([WIT](#)), and Hindalco Industries ([HALC.BO](#)) are becoming multinational competitors with globally recognized brands. China also has numerous companies that have a market capitalization of over \$1 billion, but the majority of these are state-owned behemoths recognized by their sheer size and not their nimbleness.

When the rule of law is recognized by investors and foreign companies as something that is beyond question it serves to facilitate additional investments in research and development. For instance, 150 of the top global multinationals now have research and development bases in India. Additionally the U.S. Food & Drug Administration has certified more companies in India than in any other country outside the U.S., a testament to the innovation that free markets and the rule of law foster.

LITTLE PROTECTION FOR IP IN CHINA

China has a legal system that does little to protect intellectual and physical property rights, a fact highlighted in the 2007 edition of the International Property Rights Index, which ranks China with Nigeria in protecting intellectual property rights. In fact, China's illegal copying of movies, music, and software cost companies \$2.2 billion in 2006 sales, according to an estimate by lobby groups representing Microsoft, Walt Disney ([DIS](#)), and Vivendi ([VIV.PA](#)). This figure may in fact be understated as it does not include pirated products that have been shipped to overseas markets by government-controlled Chinese companies.

The rule of law when applied evenly and justly in a democratic society also helps to ensure that wealth accumulation does not favor those individuals in political office or individuals connected to those in political office.

Democracy is a messy thing, especially when you have an electorate that exceeds 600 million people who are motivated to vote. However, democracy also helps to ensure that individual liberties are respected and that the government is responsive and beholden to the will of the people, rich or poor. A democracy also ensures accountability through impartial courts that help enforce and protect such things as property rights, environmental rights, human rights, and good governance.

India's democracy is far from perfect, but it is also quite young, and as incomes rise and the populace becomes more informed we can expect that India's government institutions will become more responsive and transparent.

And what about the hare? Consider this fact: A recent survey found that of the 20,000 richest men in China, more than 95% were directly related to Communist party officials. Where would you place your bet?

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