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India versus China – who will be the winner in the long run?

Abstract

India and China have very much in common. But both countries are also characterized by major differences. At present, the Chinese economy seems to be in the lead. This analysis shows, however, that it is far from certain that China will maintain the lead 15 or 20 years from now. China's structural challenges may prove much harder to overcome in the next decade than Western corporate leaders and analysts frequently expect. India's economic future will also be bumpy at times but probably less costly than China's conceivable way to a more open and a more genuine market economy.

Key words: China, India, Globalization, Outsourcing/Offshoring
JEL Classifications: F1, F2, F4, N3, Q1, Q5

Contents in brief

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1. Introduction

China and India are the two biggest countries in the world by population. Together, they account for roughly 40 per cent of the world's population. Both countries are now competing fiercely in the global race. However, they started their opening and reforming processes at different times and chose different strategic approaches. This makes it interesting to examine the long-term outlook for these two giants. Which will be the winner?

International market players have been focusing on *China* for two decades – but on a broad basis only since the mid 1990's. China's development very well reflects the different stages in the intensified globalization process that started in the late 1980's. China is itself an important part of this development. This is why China offers good opportunities for economic analysis despite its lack of transparency.

In the late 1980's and in the first half of the 1990's, China was increasingly singled out as a potential market for foreign merchandise exporters. After this initial change, more and more companies started to invest directly in mainland China – cautiously in the beginning – and often from Hong Kong, Taiwan, Singapore and Japan. A couple of years later, Western corporations also began to invest in China more aggressively, both for market potential and for sales reasons.

The ongoing third stage of foreign activities in China concentrates on outsourcing and offshoring, *i.e.* production in China for cost reasons. Consequently, the debate on outsourcing of jobs has become more intense in Europe – including Sweden – and the U.S.

Recently, a fourth reason for investing in China has become more evident: the outsourcing of research and development. China welcomes such investment in order to increase its human capital formation and, thus, to achieve more value-added in industrial production in the longer run.

This relatively new trend has not been recognized sufficiently outside China, but is becoming an increasingly important part of business deals between Western and Chinese investors. It seems a safe forecast that the outsourcing of research will become a very sensitive topic in foreign board rooms and ministries at some point in the future.

India must be seen differently. India is lagging compared to China in its official global strategy, and in its receptiveness to investment plans of global foreign companies. Exports to India and FDI are increasing – but they are far behind the Chinese figures. Outsourcing and offshoring by foreign companies to India are reported increasingly – but mainly in the service (IT) sector. But they are still not very widespread.

In total, China seems to be at least a decade ahead of India in its international economic activities, possibly more. India, however, is now working much more ambitiously in its long-term attempt to catch up to China.

Many analysts predict that China will be the long-term winner in its race with India, in GDP per capita or in global competitiveness. The objective of this discussion paper is to find out if this is a safe forecast. Or will India have caught up space 15-20 years from now, or even be ranked as the biggest economy in the world in terms of GDP (purchasing power related, PPP)?

2. The analytical method

Cross-country analyses and forecasts between two or more countries can be made in different ways. Approaches can be

- quantative (based on statistics and econometric models)
- qualitative (based on judgments)
- a combination of quantitative and qualitative thinking.

We skip the model approach in this paper since it is very time-intense and China cannot deliver a satisfactory quality in its historical and current statistics. Instead, we use the second – qualitative – way, which is supported by our judgments. These are based on experience, many talks with experts over the years, literature and certain statistics.

To some extent, we also apply the combined quantitative and qualitative approaches: using our survey of international – non-Indian and non-Chinese – economists, who have an understanding of both economies. This mix of country knowledge, however, is still not often found.

Long-term forecasts always are based on assumptions that cannot be maintained completely during the forecast period. We, therefore, recommend interested readers to keep themselves informed on India and China on a regular basis, in order to single out new opportunities.

A big number of academic economists have defined important factors that determine long-term growth in an economy. We would like to introduce some of the modern academic findings about growth factors that will be important to long-term growth in India and China.

➢ Political development

It is a tough call to have a long-term opinion on politics. Politics in China in ten or fifteen years from now in particular can hardly be foreseen by scientific methods. However, it is necessary to have a view on this topic in order to have a consistent long-term economic outlook.

➢ Factor productivity

An analysis of modern factor productivity theory goes back to Nobel prize winner Robert Solow, who defines the volume of production as a function of labor input, capital input and the residual technology. In this study we look at all three factors that determine growth according to the Solow model – but separately without paying specific attention to total productivity outlook (TFP). It seems impossible to make calculations on TFP, since the proportion of the different factor inputs do not remain constant over time. Apart from that, important studies, Alwyn Young [1)] and others concluded that the rapid growth in East Asia could be attributed to rapid growth in labor and capital inputs rather than to marked improvements in TFP, which, of course – if Young's conclusion is right – may change during the coming two decades.

For emerging economies like India and China, special attention should be paid to the accumulation of capital (machinery and equipment) because of usually relatively high marginal productivity gains for new investment. In the end, long-term growth is obviously a function of developing and using technology.

➢ The investment climate

For technology to have a prominent role in growth, an attractive investment climate is absolutely necessary. This is particularly true of foreign direct investment (FDI). The climate for FDI – and for economic policy in general terms – is a function of political, economic and psychological factors.

➢ Human capital formation

Modern growth research in the 1980's and the early 1990's came to the conclusion that a very important determinant had been neglected too long: the formation and utilization of human capital. Better or increased input of human capital improves the possibility of developing, producing and/or applying technology.

Today, the well-known Mankiw/Romer/Weil model [2] belongs to basic teaching in economics. MRW regard their work as “an augmented Solow model that includes human as well as physical capital” and that “provides an excellent description of cross-country data.” Bernanke/Gürhaynak [3] go even further and include other behavioral indicators such as the saving rate that they “find strongly correlated with long-run growth rates”. Many of these variables are part of the qualitative approach of this paper.

➢ Institutional conditions

Nobel Prize winner Douglass North, Oliver Williamson and others deserve a lot of recognition for their research on the importance of institutions for a country's economic development. Numerical estimates of the effects of institutional changes are hard to achieve. This does, however, not diminish the value of improved institutions. Institutions should not only be regarded as “public building one visits” but should also include traditions and habits.

In other words, there are formal and informal institutions. Examples are the rule of law, the financial system, corruption, etc.

➢ Fiscal and monetary policy

A country’s fiscal position is always important in a growth analysis, as it gives necessary information – in the Indian and Chinese cases especially – on future spending power on human capital, infrastructure, etc, unless new spending priorities are set. Globalized financial markets watch this indicator in emerging markets very closely. This is true of inflation and monetary policy, too. For poor countries like India and China, low inflation is very important for reasons of income distribution as well. The poor need low inflation. Inflation creates social tensions, and these are never good for a country's growth, or political stability.

➢ Infrastructure

Infrastructure improvements are crucial to optimize conditions for (foreign) investment and production. These include roads, railway, airports and other means of communication.

These factors mentioned above should be watched very carefully when comparing the medium- and long-term outlook for India and China. Of course, many other factors could be added to the determinants of growth in the longer run. Some of them will be discussed in the competitive analysis in chapter five.

3. The political systems: India's democracy versus China's one-party state

Opinions vary about the extent to which an emerging transition economy benefits from a certain political system. Should democracy already be in place before an economic reforming process is started? Or is the opposite approach more promising, i.e. starting economic reforms before the political system is changed?

The Chinese themselves often point at the disappointing Russian economic performance since their democratization – stressing that political reforms in Russia were started before economic reforms.

China, on the other hand, has been reforming its economy since 1978, without noticeable democratic reforms. All political reforms in China so far have been implemented within the framework of the Communist Party. It is hard to see this changing any time soon.

Thus, the political system and economic reforms in China will continue to be based on the rules of the Communist Party, at least for the foreseeable future. Further reforms of economic policy could, therefore, lead to frictions with the ideologues, if the current political system remains in place. This political risk should not be neglected, if China limits gradual political liberalization in line with its planned ongoing transition to a market economy. In my opinion, China still has a long way to go before being considered a market economy, even if it invests a lot of political pressure to be recognized internationally as a market economy, particularly by the EU. Even bilateral commercial deals have begun to be linked by the Chinese to this recognition – mainly for prestige reasons.

However, the Chinese government still has far too much impact on microeconomic and institutional processes despite considerable progress in getting its economy ranked as a market economy. Economic freedom and the freedom of choice are fundamental to a market economy.

India, on the other hand, is a democracy. Its democracy is embedded in a federal system. Democracy means that economic policy decisions take more time to implement and are often the result of compromise. Consequently, policies can be less effective than originally planned. This should not be seen as a disadvantage in the longer run.

The Indian government, for example, six years ago decided to introduce VAT. In spring 2005, however, only 21 out of 29 states had followed the decision of the central government. Indian policy measures need to be broadly based. This takes time. China, on the other hand, can implement measures or reforms much faster once a decision is made, but based on less democratic consensus.

Goyal/Jha [4)] comment on this phenomenon as follows: "China has the lead given its clear goals and pragmatic, flexible stance. Its non-transparent accounting systems and authoritarian regime gave it the freedom to follow stimulatory macro policy when it was necessary even if it led to high volatility, or imposed short-term hardship on the populace."

Both China's and India's political characteristics have been in place during their entire economic reforming processes. This makes it understandable that preconditions for reforms have been very different in both countries – and will remain so. This should go on favoring the Chinese pace of reforms in the short and medium term, but not necessarily in the long run.

In the long run, the (theoretically) foreseeable conflict between (more) market economy and the one-party-system can create new and unforeseeable challenges for Chinese economic policy.

Analysts and corporate leaders should not underestimate the importance of political developments on future economic growth. In this context, India seams to be a safer haven than China, despite some remaining political/institutional shortcomings. That said there are certain domestic political risks, e.g. Kashmir, that India may also face some time in the future. For China, these could come from farmers, other disappointed groups in the society or economically lagging regions.

The future domestic political risk seems to be higher in China than in India. However, safe prediction methods do not exist. No one can rule out a smooth Chinese transition to democracy in the longer run when a new, younger and less dogmatic generation of political leaders takes over.

Finally, foreign policy should be considered in a long-term growth perspective. In this respect, China's future seems to be more uncertain than India's.

Historically, India and China have not been friends. In 1962, there was even a short war between the two countries. Nowadays, relations between China and India have normalized, including plans for closer economic co-operation. Today, there is no reason to foresee a future serious conflict between China and India affecting growth in the two countries.

However, there are other areas of potential international conflicts/war for China and India.

Inside and outside India, there are still fears of a future conflict with Pakistan. However, it seems to be possible that this risk will decline gradually, as both the current Pakistani and Indian leaders seem more committed to peace between the two countries than their predecessors. The remaining risk, of course, is that future governments in India and/or Pakistan may consider different options.

Apart from this, it seems plausible to conclude that India in the long run will get more western “sympathy points” than China. This could also include international trade tensions. There are western elements in the Indian society that do not exist in China. Western representatives certainly appreciate this compared to the opaque and nationalist Chinese system, which does not have a rule of law.

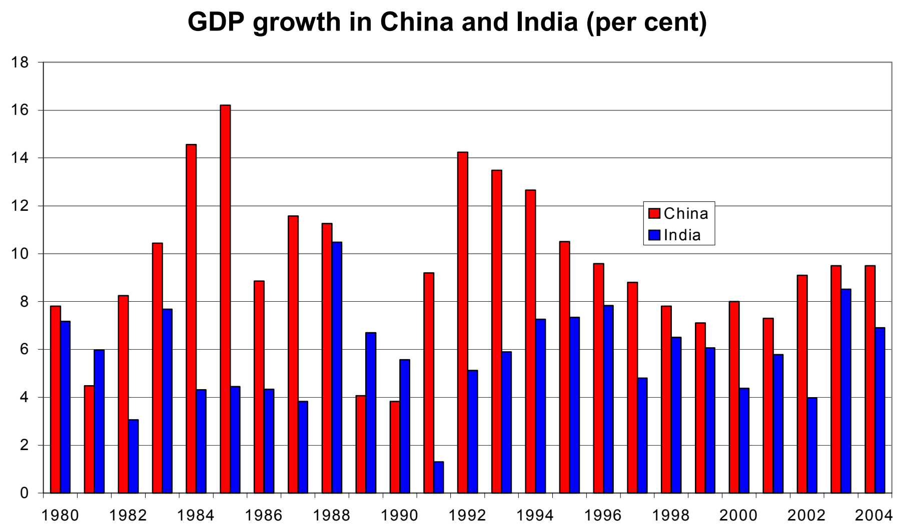
China and the United States have found a modus vivendi for the time being – but are not friends. Future tensions cannot be ruled out. These tensions may, for example, concern the political issue of Taiwan and future Chinese international trade expansion, with protectionist reaction, especially from the U.S. and/or EU. Apart from this, no promising Chinese/Japanese friendship seems to be in the cards.

Consequently, it is hard to recognize a steady pro-China international political environment among some of the big OECD countries.

Conclusion: Advantage India in the medium- and long-term political analysis.

4. What do statistics tell us?

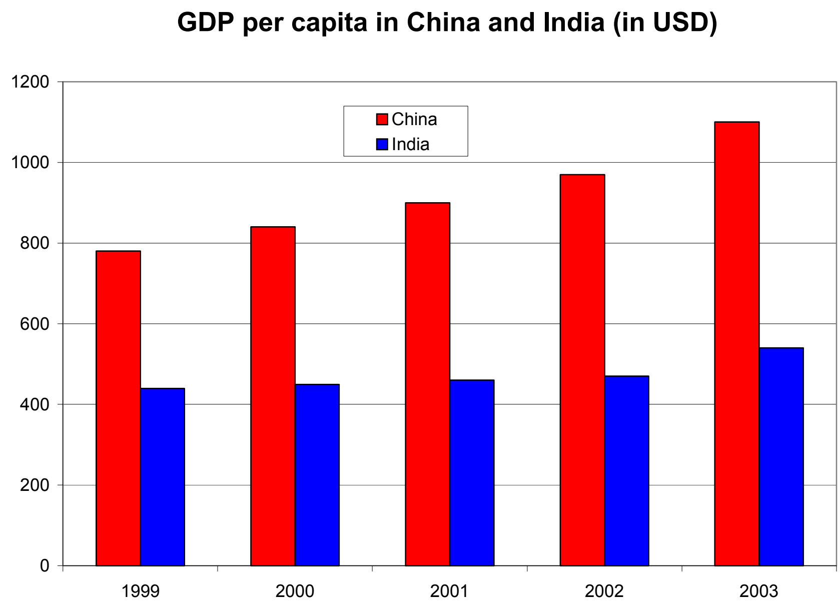
This chapter is not aimed at analyzing the quality of Indian and Chinese statistics, even if Indian statistics in most respects are of a higher standard. Rather, our idea is to use statistics to compare the two countries economically – accepting the existing statistical shortcomings. Numbers that we, however, ex ante consider being totally incomparable, are neglected in this overview.



Source: Ecowin

Comment:

There is no doubt that China has the lead when it comes to average GDP growth over the past 10-15 years. We know that an important share of this surge can be traced to the input of capital (FDI). On the other hand, India clearly has a chance to catch up.



Source: World Bank, Atlas method

Comment:

The development of GDP per capita almost tells the whole story of the past. Twenty-five years ago, India had approximately the same per capita GDP as China. Since then, China managed to quadruple its GDP per capita. India only doubled theirs. Whatever opinion one may have on the quality of Chinese statistics, it should be clear that China has been jumping away from India in growth terms. But both countries have reduced poverty. This is for example described by John [5] who also looks at the less favorable development of income distribution in both countries.

If we assume that China will grow by 6% in the long term and India by a high – but theoretically achievable – 8%, it will take India almost 30 years to catch up with China. This example underlines the fact that India so far has missed great opportunities both before and during the intensified globalization process. This does not, however, rule out more ambitious Indian catching-up attempts in the future.

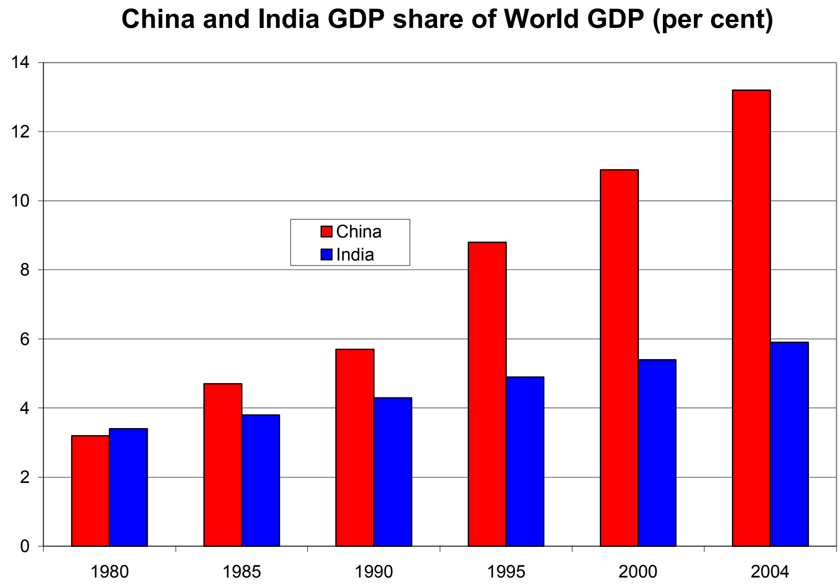
GDP growth per capita (%)

	2000	*2001*	*2002*	*2003*	*2004*
India	2.5	3.9	2.2	6.7	4.7
China	7.2	6.8	7.7	8.7	8.9

Source: ADB

Comment:

Even if GDP figures do not tell very much about income distribution, the figures in this table reflect more dynamism in the Chinese economy compared to the Indian. India, however, seems to increase its own speed.



Source: IMF

Comment:

In the early 1990's, the shares of China and India in global GDP were roughly 4 ½ % and 6 %, respectively. Now, these proportions are around 6 and 13 % which clearly reflects the different speeds in growth. It also can be observed that China and India together already now count for one fifth of global GDP – a world market share that most certainly will increase further in the future.

Sector share (2003, %)

	Agriculture	*Industry*	*Services*
India	21.7	26.9	51.4
China	10.2	68.0	24.3

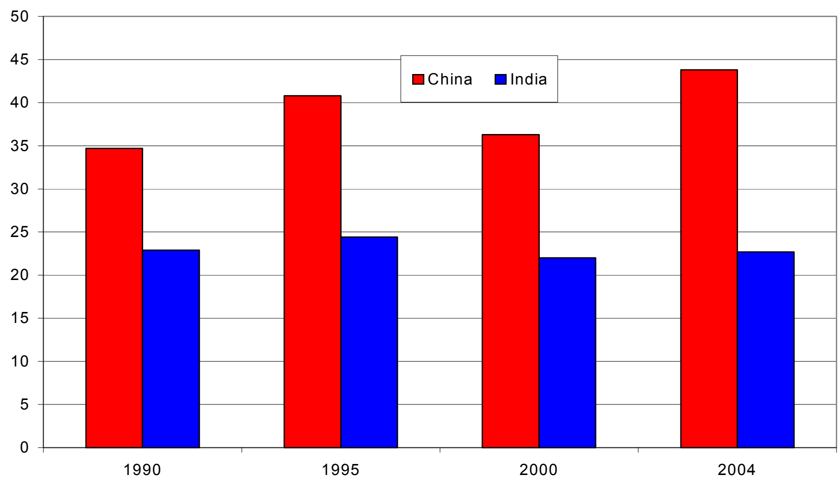
Source: ADB

Comment:

Both countries have an unfavorable mismatch in their sectoral production. India has quite a small share for its industrial production whereas as China has a very big one – or rather a too big one. On the other hand, China has a limited service sector and India probably a relatively big one. The probable outcomes in the long run will be

- that China will increase its service sector, at the expense of industry and probably agriculture
- that India will increase its industry share in production, and decline very gradually in agriculture.

Gross domestic investment (% of GDP)

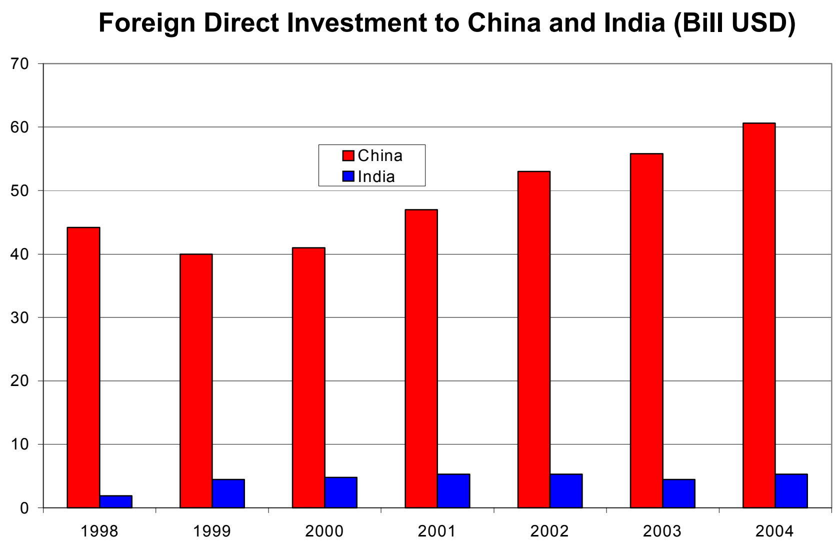


Source: Ecowin

Comment:

Emerging economies pursuing successful policies usually have relatively high investment ratios related to GDP. India's investment ratio is rather low, but probably will rise in the next few years. China's ratio, however, is completely the opposite – far too high. China's high investment ratio means by definition

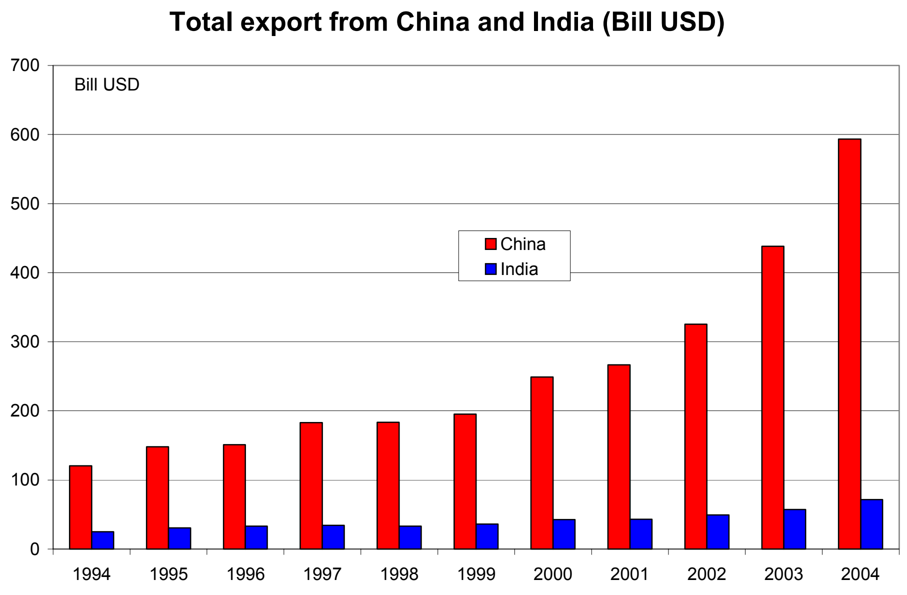
- that there is too little room for private and public consumption and
- that capital can be allocated to questionable or poor investments. When resources are not optimized, that creates the possibility of new non-performing loans. This risk must be seen against a background of huge non-performing loans. (the already existing must be seen as an enormous problem).



Source: UNCTAD

Comment:

The rapid growth of FDI in China stands in contrast to India. On the other hand, India's disappointing historical FDI performance create a large theoretical potential if conditions for foreign investment can be improved further.



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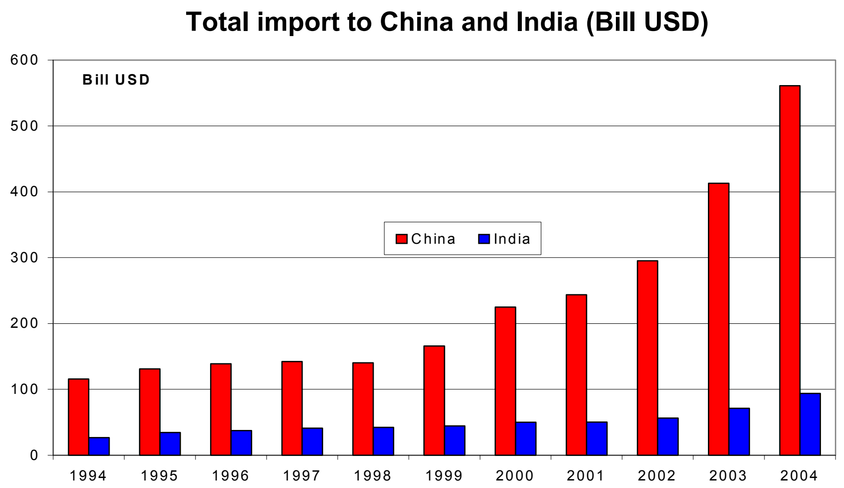


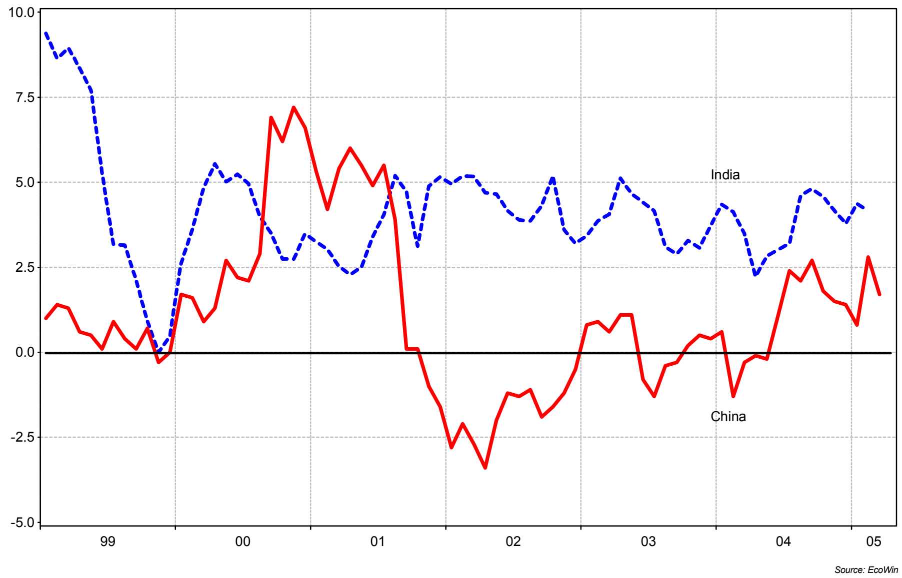
Source:Ecowin

Comment:

These two graphs for merchandise exports and imports show nicely how much India is lagging in exports and imports compared to China.

Inflation

Inflation rate in China and India (per cent)



Comment:

Both India and China seem to have acceptable inflation rates these days. Neither India nor China are high inflation countries, according to official statistics. Low inflation is also very important from an income distribution point of view. This, despite, the obvious difficulty of measuring CPI in big emerging countries like India and China.

However, emerging markets can have hidden inflation risks greater than traditional OECD countries, particularly when the central banks have no inflation targeting like in India and China.

Despite their economic progress, India and China both face many structural challenges. These are greater for China than for India.

Both India and China are "condemned" to high growth, particularly in order to increase private income and the purchasing power of their people. Ultimately, this means their importing capacity must be enlarged. That gives new opportunities for exports from the U.S., Germany, Sweden etc. to these two big potential markets. If the Western world wants to increase its own potential, outsourcing to India and China has to be accepted.

This is certainly an attitude that India expects from other countries. Or like the global well-known Indian economists Bhagwati/Srinivasan (Columbia/Yale) put it together with Panagariya [6)]: "It would be very useful to discuss outsourcing as a trade phenomenon, with effects that are not qualitatively different from those of conventional trade in goods." The authors hope that their analysis will dispel some of the fear of outsourcing. They see outsourcing as a tool to create and expand high-value jobs in the outsourcing country.

5. India versus China – a short- and long-term competitive analysis

Basic facts and statistics confirm the general view that China at this point is well ahead of India in most economic development terms. If we assume that China's GDP will stagnate from now on and India in the future will achieve a 6 % GDP growth rate, it will take India 10 years to catch up. Taking 5 % would mean 12 years to catch up with China, and a growth rate by 8% just 8 years. Please note that this is an example with simultaneous Chinese GDP stagnation – not a forecast. However, the example shows that India must perform very, very well to get in line with China, or that China must have a disappointing growth rate.

Given the increasing global attention paid to India's economic development, it is useful to examine India's competitive advantages and disadvantages.

There are no scientific quantitative ways of forecasting the Indian or Chinese development of institutions, human capital, political organization etc. For this reason, emphasis in this paper is put on qualitative judgments of the current situation and, if possible, extrapolation and/or trend analysis is into the future.

We refrain from weighting all the important factors that determine the future of India and China. Certain factors may gain momentum in the future, others will have decreasing importance. Economic development is dynamic – not static.

But let's get back to some of the main factors of crucial importance to growth that were mentioned in chapter two.

Growth factors – conditions of today *)

Political stability (without regarding the system)	China	+
Democracy	India	++
Western political support	India	++
Institutions	India	++
Property rights	India	++
Banks	India	++
Stock and bond markets	India	++
Productivity growth	China	++
Labor-market flexibility	China	++
FDI climate	China	++
Human capital (broadly based)	China	++
Human capital (on top levels)	India	++
Health	China	+
Infrastructure	China	++
Economic policy tools (including monetary policy)	India	++
Fiscal policy / public debt	India	0 / +

*) Own judgments (++ indicates substantial lead, + some lead, 0 roughly equal positions)

This brief comparison shows that China at this point has somewhat more favorable conditions for short-term growth, whereas India is characterized by some particular factors favoring long-term growth such as democracy, institutions, financial markets and demography.

6. India and China – in a short- and long-term corporate perspective

Corporate leaders may think differently from economists as far as their market and investment strategy is concerned. Mostly, big- or medium-sized global companies – using James Tobin's words – are more "risk lovers" than most economists. Small enterprises, on the other hand, tend also to be cautious. Consequently, corporate leaders outside India and China can develop different strategies. Ultimately, there is no single formula for the corporate world. Final decisions have always to be made on an individual country level. This should, however, not be done without necessary analysis of political, social, macroeconomic and microeconomic conditions. Particularly in the case of China, some obvious herd behavior by foreign investors can be found [7]. It remains to be seen if a similar phenomenon will show up in India at some point.

Whatever conclusion one may make on the future position of China and India in the world economy, both countries have their interesting commercial aspects. Both countries, for example, have a sizable and increasing middle class of about 200-400 million people, depending on the definition of the segment “middle class”. In any case, these are markets that are targeted by many foreign companies. Investment in infrastructure is still very urgent in both India and China – despite China's advantage. Health care and education are other sectors of strategic interest for some foreign companies. For others, the focus is on luxury consumer goods.

Foreign companies with planned activities in India and China should be aware of major differences in the institutional and legal infrastructures. India has great advantages in these respects. China enjoys instead better productivity in a substantial number of sectors, and a much less rigid labor market than India. According to Qin [8], a shift from agricultural to the tertiary sector is already going on in China, despite the statistical difficulties of measuring the services sector.

Foreign companies with a long-term perspective should assume that the current “division of labor” between India (concerning services) and China for manufacturing probably will not go on forever. This means that India over time may be well see substantial manufacturing growth, while China may well enjoy substantial service-sector growth. No one can expect that the two Asian giants can achieve long-term development without any political, social or economic distortions. For this reason, globalized companies probably will treat India and China more and more from a risk diversifying point of view, from a purchasing, production and sales viewpoint. In the medium term, India should look like it will become a much more attractive market for international purchasing managers, manufactured goods included.

The time horizon until a foreign investment starts to pay off must be seen as another topic of great importance. Generalized conclusions in this specific context are difficult. China may be ahead of India by at least some 10-20 years in its catching-up process. So it seems plausible to assume that domestic competition will become noticeably tougher in China before such a change will be observed in India. In turn, that implies margin pressures may first emerge in China.

7. India and China – complementary or competing?

This chapter has only one aim: to examine the plausibility that China and India are complementary producers. China's prime minister Wen Jibao during his visit to India in March 2005 announced this proposition.

There are many reasons – some of them have been cited in this paper – that justify the forecast that China over time will evolve toward the production of services, while India moves toward manufacturing production. This makes India and China both complementary and competing countries in the medium and long term.

If we just get back a couple of years, India was ranked in quite a lower "emerging market" attractiveness league than China. Now economists and business people talk about India *and* China. India is certainly gaining international prestige. This calls for good political leadership which is very well described by Agerwal [9)]: "What India needs today is not only quantity of service but also the quality of service in governance of the country."

8. Swedbank's Panel on the outlook for India and China

It is difficult to make GDP projections for 10-20 years ahead. For this reason, we prefer to introduce a survey of economists having an understanding of both India and China. Around 25 experts participated in Swedbank's study which was made in May 2005, with the following results:

a) Rank – if possible – the five most important competitive advantages of India / China?

India

- (Partially) good human capital formation and technical skills
- Democracy / rule of law
- Good skills in English
- Low (wage) costs
- Good IT and service skills

China

- Labor costs
- Size of the country / market / production
- Ambitious and hard-working labor force
- Geographical location
- Improved infrastructure

Comment:

The survey characterizes the advantages of India and China in a way one would expect. The only surprising point is that China's infrastructural improvements already have received broad international recognition.

b) Mention – and rank if possible – the five biggest impediments to future growth in India / China?

India

- Poverty / regional disparities
- Bureaucracy
- Insufficient infrastructure
- Political conflict potential, domestically and externally
- Corruption

China

- Poor big banks – high bad loan (NPL) level
- Corruption
- Insufficient protection of property rights
- Regional income disparities
- Poor corporate governance

Comment:

The Indian and Chinese impediments to more growth do not vary much in their basic nature.

c) What are – in your opinion – the five biggest medium / long term risks for foreign companies doing business with India / China?

India

- External and/or domestic political conflict
- Slow speed of reforms
- Insufficient infrastructure
- Corruption
- High hurdles for FDI

China

- The bad loan problem (NPL) of the banks
- An inappropriate exchange rate policy
- Potential domestic political problems
- Poor protection of property rights
- Corruption

Comment:

It is obvious that political and microeconomic factors dominate the risk analyses of our panel. Political risks and widespread corruption are risks for both countries, according to the panel.

d) Which strategy would you prefer when considering India and China commercially?

- Concentrating mainly on India: 5 %
- Concentrating mainly on China: 5 %
- Concentrating on both: 90 %

Comment:

The answer to this question is obvious. From a corporate point of view, India and China should not be mutually exclusive. This, even if individual companies have other priorities.

e) Applying a long-term perspective, do you think that

- India can catch up with China: 35 %
- India can leave China behind: 16 %
- India will stay behind China: 49 %

Comment:

It should not be a surprise that our panel sees China being clearly ahead of India even in a longer perspective, since China at this point already has the lead. However, this survey also reflects an interesting degree of confidence in the future of India. Half of the participants thought India had a chance to catch up with mainland China. India's international reputation may be more favorable than most people anticipated.

9. The outlook

Who will be the winner in the long run in this Indian / Chinese race?

No clear answer was found in this analysis. In the short and also in the medium run – i.e., 2-3 to 8-10 years ahead – the odds are that China will keep its leading position, despite major shortcomings compared to India. China has at present some comparative advantages that probably will contribute to a superior economic position at least until the end of this decade such as

- steadily strong domestic investment, partly due the Olympics in 2008 and the World Expo in Shanghai in 2010
- further strong foreign investment and/or foreign purchasing in China
- continuously growing middle class
- more opening for competition

- avoiding serious bubbles or imbalances lead to "explosions", for instance in the banking sector, state-owned enterprises, real estate market, the environment etc.

Looking beyond 2020, India has a realistic chance of catching up with China, if necessary reforms are implemented. Under this assumption, some of the major Indian competitive advantages could become particularly beneficiary for economic development. These include democracy, the rule of law, favorable demographic conditions, special skills in engineering and mathematical thinking and – in certain respects – more westernized ways of thinking than in China.

However, these probably lasting comparative advantages can only be optimized if globalization receives continued acceptance in line with Baghwati's pleading. And it should be repeated: India should do much more about its uneven education standard and focus more intensely on general education of the rural and poor city populations.

On the other hand, it seems to be a safe forecast that in the beginning of the next decade China will be able to produce more sophisticated manufactured goods and services than it can today. If so, it would be due to a lot of imported technology and to ambitious political and private entrepreneurial leadership. This should enhance China's advantages in the medium run.

China's major challenges in the future will be the collision between the market economy and the maintenance of the Communist Party's political monopoly. In addition, China will continue to face unemployment and regional disparities, while trying to create a healthy financial system.

In the future: Can China manage three big transition processes in the next decade? These include

- political transition to some kind of democracy when the fifth post WW II leadership generation takes over in the next decade
- the introduction of a genuine market economy and
- a social system that keeps the society together, both in terms of income distribution and acceptable minimum standards for social security and pensions?

Despite these limits, there is good reason to predict the India gradually will get closer to the economic performance of China. Half of our survey participants think that India can catch up with China economically in the long run, but the other half predicts that India will not. Equally important: Almost all judgments conclude that India will narrow the gap with China.

If China wants to be successful in the long run, there will be high transition costs that are mostly neglected in current analysis. These transition costs will be in areas where India is relatively competitive already.

For this reason, India will have a good chance to narrow China's current lead, particularly in the next decade. Can India catch up to China in terms of GDP per capita over the next 20 or 25 years? Evidently, that cannot be answered. In the end, demography could give India a considerable economic advantage if economic policy creates favorable conditions. Almost 50 percent of the Indian population is below 19 years of age. The average age of Indians is 24 compared to 32 years in China.

10. Conclusion

India or China? Who will be the winner in short and long run?

China seems to be the winner in *the short run*. It seems to have the best possibilities of remaining ahead of India in the years ahead.

However, no decisive answer can be given to the question about the lead in *the longer run*. There is a high probability that India clearly will gain momentum in its catching up process with China. India has competitive advantages that should pay off more positively in a longer perspective.

Predicting that India *and* China will be increasingly important global economic players and markets, is not a very courageous forecast. These two Asian giants will concentrate more and more global economic power which no one in the western world should underestimate. This economic power will create more challenges, including the global supply of commodities and for the concentration of the global environment.

In a more cautious scenario, the Indian and Chinese success stories could be reversed at some point. No one can rule out domestic or international distortions forever, particularly not in China. But China will keep the lead for quite some time.

However India and China develop, one thing is clear: Enormous economic power will be created in Asia.

Something the developed world should not forget – also when considering global environment. Paul Kennedy [11)] pointed at that challenge already in 1993.

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