India: The Future Economic And Knowledge Super Power?

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ABSTRACT

India and China are the only countries in the world having a population of over one billion each. Until the 1980s, their economies were among the poorest in the world. India has been the largest democracy since 1947 but heart-rending sights of extreme poverty can be seen even in the flourishing business capitals. There are no subways, very few highways which results in nightmarish tangle of traffic all the time. China has been under the communist rule since the revolution led by Mao Tse Tung in 1966 and still continues to be under the centralized communist rule. Both the countries operated under centralized planning and kept their economies closed to global markets. However, in the past two decades, the world is witnessing a strange miracle taking place in both the countries. In the early 1980s, first China and later, India, started opening their economies to foreign direct investment and began participating more and more in global trade. The world had never witnessed this rare phenomenon of two relatively poor countries that together consist of a third of the world's population, simultaneously taking off on a steep ascent in their economies. During the past twenty years, China has been growing at a heady rate of over 9% a year and India has growing at over 6% per year. This miraculous and sustained growth of these two countries is being watched by the rest of the world with mixture of surprise and apprehension. At this rate, it is expected that, within the next two or three decades, India and China together would account for over half of the entire world's output. This paper presents the several factors of the phenomenal development of the Indian economy and analyses the impact of continued rise in their prosperity on the global economy.

INTRODUCTION

India and China are the two most populated countries in the world, each with a little over 1 billion people. Both countries have long and ancient history. Both are unique in having an unbroken stream of ancient culture and civilization for centuries before the dawn of the Christian era. Populations of both countries consist of very highly educated and technically skilled work force. In both countries, there is very large middle class, progressively becoming very hungry for vast quantities of consumer goods.

Until the late 1970's, both India and China have closed their economics to the outside world. There was very little foreign trade and the domestic markets of both countries were closed to foreign direct investment (FDI). Surprisingly, both countries appear to have realized the futility of their restrictive economic policies, at the same time. Around the early 1980's, both India and China started to liberalize their economics and began to open their markets for foreign investors and FDI funds started flowing into the countries.

HISTORICAL BACKGROUND

After nearly 400 years under the British rule, India attained independence on August 15, 1947. The country began its tenure as an independent country, with a large section of highly educated English speaking population, and well defined, transparent administrative systems with checks and balances (Balakrisanan, 2,000). But, from the very outset, India launched upon what is known as a "Socialistic Pattern of Society" and followed a predictable path toward socialism (Salve, 1993). Once on this path of central planning and rigid, closed economic policy, the country was inexorably drawn into a vortex of regulations, permits and controls. The ever increasing government regulations were carried to a point where, after four decades of governmental intervention, the nation had become virtually bankrupt in almost every sphere, -- economic, political and commercial (Salve, 1993).

Eventually, the utter futility of the rigid, closed economic policy in India was recognized by the administration under Prime Minister Narasimha Rao. In the early 1990s, he had finally cast aside all the socialistic policies introduced after independence and embarked on a major reform policy, liberating the economy and opening it to foreign investors. Foreign Direct Investment (FDI) funds started to trickle into India.

Foreign Direct Investment

World Trade Organization (WTO) and North American Free Trade Agreement (NAFTA) resulted in liberalization of global trade and migration of a large number of manufacturing jobs to Mexico and other developing countries with plenty of cheap labor. With gates of the economies in India and China thrown wide open, FDI funds started pouring into the two countries. Substantial foreign capital came into India during the last decade but the amount of FDI that went into China during the same period can be compared to a tsunami. Table I below shows the respective amount of FDI received by India and China from 1996 to 2005.

Table 1
FDI Funds Inflows (U. S. Dollars – Billions)

Year	India	China
1996	2.141	41.730
1997	2.770	45.260
1998	3.682	45.460
1999	3.083	40.320
2000	2.439	42.720
2001	3.403	48.850
2002	3.449	52.740
2003	4.269	53.510
2004	5.335	60.620
2005	6.500	60.330
Total	$39.071	$491.550

Sources: Center for Civil Society, New Delhi, 2005. The US – China Business Council, 2006. www.euromoney.com, India country profile, 2006

While China began its reforms in 1979 and opened its economy to global markets, India continued in its self-imposed economic isolation until 1991 and hence the vast disparity in these two countries' ability to attract FDI.

THE OUTSOURCING PHENOMENON

Rapid progress in information technology in the past decade brought about another unexpected phenomenon. Many companies in the United States (US) are now exporting many jobs, even in the services sector, to India, China and other countries to take advantage of their low cost, and highly skilled work force. About three million service jobs are expected to be outsourced from the US mostly to Bangalore, India by the year 2015. This phenomenon is not limited to private sector alone. Many state and local governments, starving for cash, are beginning to outsource jobs in information technology to foreign countries. Outsourcing is hitting even skilled jobs that were once thought to be safe across a wide range of white-collar work force. The main reason for the speed and size of this shift is the nature of service work. Unlike manufacturing jobs which need years of time and billions of dollars to erect plants overseas, service jobs need only a desk, a computer and Net access. The recent trend of jobs migrating from the United States to India and China has created an economic and political storm in the US. To many people, outsourcing means eliminating jobs in the US and exporting them to poor countries such as India and China. However, many well known economists are of opinion that outsourcing is closely related to global trade and is beneficial to all concerned parties. They assert that people in every region of the world would be able to obtain the best quality goods at the lowest prices.

METAMORPHOSIS IN INDIA

Diana (2005) states that new parts of the world, long considered underdeveloped backwaters, are now taking center stage in the global economy. Rapid ascendancy of China's economy is much publicized as it transformed into a major venue for manufacturing of cheaper goods sought after by global consumers. India also is exhibiting a vigorously growing economy partially fueled by companies around the world trying to reduce their costs by outsourcing some of their operations to India.

An article in "New Scientist" (2005) suggests that the first sign that something was up came around the late 1990s. Stories began to appear in the international media that India was "stealing" jobs from the U S and other wealthy nations. These were not just industrial jobs like those that migrated to China, but many white-collar jobs of well-educated people. Today everyone knows that the small trickle of jobs from developed nations to India which started in the late 1990s has become a veritable flood. India now is said to be the back office of many banks, a magnet for labor-intensive, tedious programming, and the customer service voice of every company from British Airways to Microsoft (New Scientist, 2005). It is reported that during the past five years alone, over 100 Information Technology (IT) and scientific companies have located their Research & Development (R&D) labs in India. These are not routine drudge jobs. High-tech companies are coming to India seeking innovators of the future world. Their recruits are young graduates fresh from the Indian universities and elite Indian Institutes of Technology (IIT). The knowledge revolution is on and some senior scientist and officials believe that India can short-cut the established path to industrial development and move straight to a knowledge economy (New Scientist, 2005).

WHY INDIA?

Kripalani and Engardio (2003) observe that India has long possessed a strong market-driven economy, private corporations, democratic government (the largest democracy in the world), western accounting standards, an active stock market, wide-spread English usage, and schools strong in computer science and Math. As Sender (2006) states, India's English speaking, highly educated workforce has been a source of low-cost technology and service labor. India's huge, prosperous middle class of nearly 200 million provides enormous consumer goods market for global trade. As Prime Minister Singh (2006) announced recently, India's high-quality technology and management, familiarity with English, long-established commercial and legal institutions, well-established rule of law and legal systems, well-run and transparently regulated banking sector all augur well for India's competitiveness in today's global world. Ayres and Oldenburg (2005) point out that India has become one of the fastest growing economies in the world. Its knowledge industries have become global models of excellence. They also opine that it is taken for granted that not only will India be increasingly integrated into the global economy, but it also will play an increasingly important role in it.

Recently, there is a huge surge in FDI flowing into India. In June 2006, IBM CEO, Palmisano (2006) announced that it would triple its investment in India to $6 billion over the next three years. Speaking at the largest-ever gathering of IBM employees in Bangalore, the epicenter of India's technology boom, Palmisano said that the company will build service delivery centers in Bangalore to automate IT service delivery. Other investments include Microsoft's announcement of $1.7 billion its largest investment outside the U S, chip maker AMD's $3 billion, Cisco's nearly $1 billion and Intel's $1 billion.

According to Entwistle (2005), the present heightened interest among financial sponsors in India is driven by several factors:

1. The overall economic picture for India is one of explosive and sustained growth.
2. Investors developed an "Investment Thesis" based on five key factors:
    a. India's large pools of English speaking engineers and postgraduates have a proven record of providing high-end solutions to problems and world-class R&D.

b. The cost-benefits of doing business in India are still significant.
c. Over the years, India has established a reputation for delivering quality products and services, with refined process methodology, stringent quality control and general adoption of global best practices.
d. The country's time-zone advantage which enables Indian companies to program software, staff call centers, produce documents and provide myriad other services while the U S sleeps.
e. The dramatic rise in domestic consumption has provided a key corresponding impetus, along with the global interest in Indian products and services.

3. The success of several sectors of the Indian economy, such as Infosys and Wipro in IT services and Dr. Reddy Labs and Rambaxy Pharmaceuticals in healthcare, has given financial sponsors case studies to show to their investment committees.
4. India's own public equity markets have performed well attracting significant Foreign Institutional Investors (FII).
5. The emergence of robust mergers and acquisitions market has given financial sponsors through which to exit their investment.
6. The first wave of equity investors, such as Warburg Pincus, has realized significant success in recent years. (Entwistle, 2005)

Significant Sectors For Outsourcing To India

1. Research Centers: In the year 2000, General Electric (GE) established its John F. Welch Technology Center in Bangalore, India. Its 1,800 or so engineers, a quarter of them with PhD degrees, are engaged in fundamental research for most of the GE's 13 divisions including research in areas from aero-dynamic designs of turbo engine blades to molecular structures of materials used in DVDs. So far the engineers have filed for 95 US patents. The main purpose is not cost saving any more. But to speed up innovation and generate growth for the company (Kripalni and Engardio, 2003).
2. Accounting: In 2004 an estimated 200,000 US tax returns were processed in India.
3. Other Services: Companies are shifting bill payment, human resources and other functions to new, paperless centers in India. About some American customers' complaints of not understanding call center operatives in India, GE's Venable says, some of my team have fairly strong accents, but have you ever called Texas or Mississippi?" (Kripalni and Engardio, 2003).
4. Medical Tourism: A relatively new phenomenon, medical tourism involves providing high-quality medical services for about one tenth of what it costs in the US are UK, Some packages include some add-ons such as yoga holidays or a trip to the world-famous Taj Mahal. (Kripalni and Engardio, 2003).
5. BPO: Business Process Outsourcing (BPO) involves general routine processing of data. Sender observes that, on a global basis, IT/BPO services grew about 7 percent in 2005, while India-based IT/BPO companies grew 33 percent during the year. According to an S&P owned, India-based, credit rating firm, Crisil Research the compound annual growth rate for Indian exports is projected to be 26 percent through 2009 for IT services and 31 per cent for BPO services.
6. KPO: Knowledge Processing Service (KPO) is a higher level service than BPO. KPO involves high-end processes such as investment research and legal and insurance claims processing. In both BPO and KPO services, India offers phenomenal cost savings over its US counterparts. By a factor of 10 to 15 in some cases. By some estimates, India will capture a whopping 70 percent of total world KPO services by 2010 (Diana, 2005).

Present Position Of India's Economy

According to the latest (August, 2006) Indian Economy Statistical report published by the Ministry of Finance, the Indian economy currently stands among the world's fourth largest growing economy in terms of purchasing power parity and holds the distinction of being a key contributor to Asia's balance of payment surplus. According to the projections made by KPMG, India's GDP would be the third largest in the world by 2020.

There are ample reasons for India's viability as an attractive destination for foreign investment with economic prosperity in general and the rising disposable incomes in particular encouraging the inflow of MNCs into India.

Capital inflows have remained large during 2006-07. Inflows of foreign direct investment (FDI) into India (equity capital components only) during the first quarter of the current financial year 2006-07 (April-June), was US $ 1.74 billion compared to US $ 1.18 billion in the same quarter of 2005-06The number of FIIs registered with the SEBI increased from 882 at end-March 2006 to 928 by end-June 2006.

FIIs remained net buyers in July 2006 with net inflows of US$252 million compared to net inflows of US$106 million in June 2006.

Forex Reserves excluding gold and SDRs stood at US$157.25 billion at the end of July 2006. India holds the fifth largest stock of reserves among the emerging market economies and the sixth largest in the world.

India's industrial production in June rose to a higher than expected figure of 9.6 percent. The annual rise, propelled by strong manufacturing exceeded the median forecast in a Reuter's survey, which stated a growth of 9 percent.

The annual inflation rate in terms of WPI (Base 1993-94=100) was 4.82 percent for the week ended August 5, 2006.

Consumer Market

According to A. C.Nielson's consumer confidence survey - India leads the way with reference to consumer confidence at 132 points. Nearly 66 percent of Indians feel that the present is a good time to purchase in comparison to the regional and global averages of 38 and 39 percent respectively.

The Indian FMCG sector is the fourth largest sector in the economy with a total market size in excess of US$ 13.1 billion. It has a strong MNC presence and is characterized by a well-established distribution network

The FMCG market is set to treble from US$ 11.6 billion in 2003 to US$ 33.4 billion in 2015. Penetration level as well as per capita consumption in most product categories like jams, toothpaste, skin care, hair wash etc in India is low indicating the untapped market potential. Burgeoning Indian population, particularly the middle class and the rural segments, presents an opportunity to makers of branded products to convert consumers to branded products.

Growth is also likely to come from consumer 'upgrading' in the matured product categories. With 200 million people expected to shift to processed and packaged food by 2010, India needs around US$ 28 billion of investment in the food-processing industry.

The flourishing IT sector and the impact of outsourcing have opened up a number of avenues for India. Nearly 92 percent of Indians are expecting job prospects to increase substantially and 87 percent Indians believe that their personal finances are in good shape. Home improvements (38 percent) and leisure holidays (37 percent) are the other pursuits that Indian consumers are wiling to indulge in.

According to the Society of Indian Automobile Manufacturers (SIAM), the Automobile industry witnessed a growth of 16.49 percent in the period April-August 2006 in comparison to the corresponding period in the previous year.

According to the Telecom Regulatory Authority of India (TRAI) the subscriber base for telephony services remained consistent in terms of growth during the month of June 2006. At the end of June 2006 the total Fixed Lines stood at 47.42 million and Mobiles stood at 105.95 Million, taking the total of telephony subscribers in the country to 153.37 million.

Computer sales in India grew 19 percent to 1.25 million units during April-June 2006 from a year earlier, driven by a burgeoning notebook PC market.

Agriculture

Agriculture occupies a prominent position in the Indian economy. India has the second largest arable land in the world and has a diverse agro climatic zone across the country.

India is the second largest food producer in the world, with an annual production of over 210 million tons.

India ranks first in the world in the production of milk, tea, and sugarcane. It is the second largest producer of fruits, vegetables, rice, wheat, tobacco, and groundnuts and is among the top five producers of coffee, spices, cereals, and oilseeds.

India produces 41 percent of the world's mango, 23 percent of banana, 24 percent of cashew nut, 10 percent of onion, 30 percent of cauliflower, and 36 percent of green peas.

India is the largest producer and exporter of spices.

India has a huge potential for investment in the food-processing sector.

Indian agricultural trade is likely to expand in the future owing to the positive outlook in the WTO talks.

Capital Market

Vibrant capital market comprising 23 stock exchanges with over 9000 listed companies. Bombay Stock Exchange is the second largest after NYSE. Stock market trading and settlement system are world class.

Indian companies have been aggressively mobilizing capital from the overseas market for the last few years.

Indian companies mobilized US$ 3.25 billion (Rs. 14,9.873 billion) from the primary market in April 2006. Of this, 67 percent was raised from the domestic market.

Banking

According to CRISIL, the Indian banking sector is more robust than ever before. Liquidity is adequate to support overall credit growth of 25 percent, given normal deposit growth rates

Banks have raised over US$ 21.4 billion in deposits since April 1 '06, which is more than twice the US$ 10.4 billion raised during the same period last year.

A host of foreign banks from China, Japan and European countries are waiting in the wings to establish commercial presence in India.

Source: Indian Economy Statistical report published by the Ministry of Finance, August, 2006

FUTURE PERSPECTIVE

The working-age populations of US and China are expected to shrink in next two decades. In contrast, India will soon have the largest population in the world, overtaking China. By 2020, 47 per cent of Indians will be between the ages 15 and 59. It is certain that India is going to have the largest population of workers and consumers for a long time to come. Based on this situation, Goldman, Sachs & Company projects that India will have a sustained annual growth of 7.5 per cent after 2005. As Krizner (2005) states, China and India are rivaling one another and aggressively challenging the US for the spot of most favored FDI destination. China still maintains the No. 1 position, but India ascended from No. 6 to No. 3, just behind the US. India and China may be similar in many ways but the main difference is that while China is viewed as the "Factory of the world", India is being recognized as the "Brain of the

World" (India Country Profile, 2006). In a survey of executives from the world's largest companies conducted by the global management consulting firm, A. T. Kearney, the following findings were reported (Krixner, 2005).

1. Global investors view China and India as distinctly different markets. China is viewed as the world's leading and fastest growing consumer market and India, as the world's BPO and IT services provider with long-term market potential.
2. Executives indicated that manufacturing and assembly activities will be offshored to China, while India leads for IT, BPO and R&D.
3. China's FDI inflows are larger and primarily capital-intensive, while Indian FDI inflows are smaller and skill-intensive, in IT areas.
4. Companies favor China over India for its market size access to export markets, government incentives, favorable cost structures, infrastructure and macroeconomics climate.
5. However, these same companies cite India's highly educated work force, management talent, rule of law, transparency, cultural affinity and regulatory environment as more favorable than China.

As Kripalani and Engardio(2003) observe, "quietly but with breath-taking speed, India and its millions of world class engineering, business and medical graduates are becoming enmeshed in America's New Economy in ways most people barely imagine. The brilliant, educated people of India are now taking the lead in colonizing cyberspace. The hidden hands of skilled Indians are present in interactive web sites of companies such as Lehman Brothers, and Boeing. While Wall Street sleeps, Indian analysts digest the latest financial disclosures of US companies and file reports in time for the next trading day. The Indian staff troll the private medical and financial records of U S consumers to determine if they are good risks for insurance policies, mortgages, or credit cards for American Express and J. P. Morgan Chase & Company." As Goldman, Sachs predicts, if India can sustain its present growth rate it, will have the third largest economy by 2050, after the US and China. India is not yet a knowledge economy 'superpower', but it is rapidly getting there.

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