

## 6.1: Chapter Introduction

### World Economies

#### WHAT'S IN IT FOR ME?

1. How are economies classified?
2. What is the developed world?
3. What is the developing world?
4. Which are the emerging markets?

From the title of this chapter, you may be wondering—is this chapter going to cover the world? And, in a sense, the answer is yes. When global managers explore how to expand, they start by looking at the world. Knowing the major markets and the stage of development for each allows managers to determine how best to enter and expand. The manager's goal is to hone in on a new country—hopefully, before their competitors and usually before the popular media does. China and India were expanding rapidly for several years before the financial press, such as the *Wall Street Journal*, elevated them to their current hot status.

It's common to find people interested in doing business with a country simply because they've read that it's the new “hot” economy. They may know little or nothing about the market or country—its history, evolution of thought, people, or how interactions are generally managed in a business or social context. Historically, many companies have only looked at new global markets once potential customers or partners have approached them. However, trade barriers are falling, and new opportunities are fast emerging in markets of the Middle East and Africa—further flattening the world for global firms. Companies are increasingly identifying these and other global markets for their products and services and incorporating them into their long-term growth strategies.

Savvy global managers realize that to be effective in a country, they need to know its recent political, economic, and social history. This helps them evaluate not only the current business opportunity but also the risk of political, economic, and social changes that can impact their business. First, [Section 4.1](#) outlines how businesses and economists evaluate world economies. Then, the remaining sections review what developed and developing worlds are and how they differ, as well as explain how to evaluate the expanding set of emerging-market countries, which started with the BRIC countries (i.e., Brazil, Russia, India, and China) and has now expanded to include twenty-eight countries. Effective global managers need to be able to identify the markets that offer the best opportunities for their products and services. Additionally, managers need to monitor these emerging markets for new local companies that take advantage of business conditions to become global competitors.

#### Opening Case: China versus India: Who Will Win??

India and China are among the world's fastest-growing economies, contributing nearly 30 percent to global economic growth. Both China and India are not emerging economies—they're actually “re-emerging,” having spent centuries at the center of trade throughout history: “These two Asian giants, which until 1800 used to make up half the world economy, are not, like Japan and Germany, mere nation states. In terms of size and population, each is a continent—and for all the glittering growth rates, a poor one.” “Contest of the Century,” *Economist*, August 19, 2010, accessed January 3, 2011, <http://www.economist.com/node/16846256>.

Both India and China are in fierce competition with each other as well as in their quest to catch up with the major economies in the developed world. Each have particular strengths and competitive advantages that have allowed each of them to weather the recent global financial crisis better than most countries. China's growth has been mainly investment and export driven, focusing on low-cost manufacturing, with domestic consumption as low as 36 percent of gross domestic product (GDP). On the other hand, India's growth has been derived mostly from a strong services sector and buoyant domestic consumption. India is also much less dependent on trade than China, relying on external trade for about 20 percent of its GDP versus 56 percent for China. The Chinese economy has doubled every eight years for the last three decades—the fastest rate for a major economy in recorded history. By 2011, China is the world's second largest economy in the world behind the United States. Gopal Ethiraj, “China Edges Out Japan to Become World's No. 2 Economy,” *Asian Tribune*, August 18, 2010, accessed January 7, 2011, [www.asiantribune.com/news/2010/08/18/china-edges-out-japan-become-world%E2%80%99s-no-2-economy](http://www.asiantribune.com/news/2010/08/18/china-edges-out-japan-become-world%E2%80%99s-no-2-economy). A recent report by PricewaterhouseCoopers forecasts that China could overtake the US economy as early as 2020. Suzanne Rosselet, “Strengths of China and India to Take Them into League of Developing Countries,” *Economic Times*, May 7, 2010, accessed January 3, 2011, <http://economictimes.indiatimes.com/features/corporate-dossier/Strengths-of-China-and-India-to-take-them-into-league-of-developing-countries/articleshow/5900893.cms>.

China is also the first country in the world to have met the poverty-reduction target set in the UN Millennium Development Goals and has had remarkable success in lifting more than 400 million people out of poverty. This contrasts sharply with India, where 456 million people (i.e., 42 percent of the population) still live below the poverty line, as defined by the World Bank at \$1.25 a day. Suzanne Rosselet, “Strengths of China and India to Take Them into League of Developing Countries,” *Economic Times*, May 7, 2010, accessed January 3, 2011, <http://economictimes.indiatimes.com/features/corporate-dossier/Strengths-of-China-and-India-to-take-them-into-league-of-developing-countries/articleshow/5900893.cms>. Section 4.1 will review in more detail how we classify countries. China has made greater strides in improving the conditions for its people, as measured by the HDI. All of this contributes to the local business conditions by both developing the skill sets of the workforce as well as expanding the number of middle-class consumers and their disposable incomes.

India has emerged as the fourth-largest market in the world when its GDP is measured on the scale of purchasing power parity. Both economies are increasing their share of world GDP, attracting high levels of foreign investment, and are recovering faster from the global crisis than developed countries. “Each country has achieved this with distinctly different approaches—India with a ‘grow first, build later’ approach versus a ‘top-down, supply driven’ strategy in China.” Suzanne Rosselet, “Strengths of China and India to Take Them into League of Developing Countries,” *Economic Times*, May 7, 2010, accessed January 3, 2011, <http://economictimes.indiatimes.com/features/corporate-dossier/Strengths-of-China-and-India-to-take-them-into-league-of-developing-countries/articleshow/5900893.cms>.

The Chinese economy historically outpaces India’s by just about every measure. China’s fast-acting government implements new policies with blinding speed, making India’s fractured political system appear sluggish and chaotic. Beijing’s shiny new airport and wide freeways are models of modern development, contrasting sharply with the sagging infrastructure of New Delhi and Mumbai. And as the global economy emerges from the Great Recession, India once again seems to be playing second fiddle. Pundits around the world laud China’s leadership for its well-devised economic policies during the crisis, which were so effective in restarting economic growth that they helped lift the entire Asian region out of the downturn. Michael Schuman, “India vs. China: Whose Economy Is Better?,” *Time*, January 28, 2010, accessed January 3, 2011, [www.time.com/time/world/article/0,8599,1957281,00.html](http://www.time.com/time/world/article/0,8599,1957281,00.html).

As recently as the early 1990s, India was as rich, in terms of national income per head. China then hurtled so far ahead that it seemed India could never catch up. But India’s long-term prospects now look stronger. While China is about to see its working-age population shrink, India is enjoying the sort of bulge in manpower which brought sustained booms elsewhere in Asia. It is no longer inconceivable that its growth could outpace China’s for a considerable time. It has the advantage of democracy—at least as a pressure valve for discontent. And India’s army is, in numbers, second only to China’s and America’s... And because India does not threaten the West, it has powerful friends both on its own merits and as a counterweight to China. “Contest of the Century,” *Economist*, August 19, 2010, accessed January 3, 2011, <http://www.economist.com/node/16846256>.

India’s domestic economy provides greater cushion from external shocks than China’s. Private domestic consumption accounts for 57 percent of GDP in India compared with only 35 percent in China. India’s confident consumer didn’t let the economy down. Passenger car sales in India in December jumped 40 percent from a year earlier. Michael Schuman, “India vs. China: Whose Economy Is Better?,” *Time*, January 28, 2010, accessed January 3, 2011, [www.time.com/time/world/article/0,8599,1957281,00.html](http://www.time.com/time/world/article/0,8599,1957281,00.html).

Since 1978, China’s economic growth and reform have dramatically improved the lives of hundreds of millions of Chinese, increased social mobility. The Chinese leadership has reduced the role of ideology in economic policy by adopting a more pragmatic perspective on many political and socioeconomic problems. China’s ongoing economic transformation has had a profound impact not only on China but on the world. The market-oriented reforms China has implemented over the past two decades have unleashed individual initiative and entrepreneurship. The result has been the largest reduction of poverty and one of the fastest increases in income levels ever seen.

China used to be the third-largest economy in the world but has overtaken Japan to become the second-largest in August 2010. It has sustained average economic growth of over 9.5 percent for the past 26 years. In 2009 its \$4.814 trillion economy was about one-third the size of the United States economy. “Background Note: China,” Bureau of East Asian and Pacific Affairs, US Department of State, August 5, 2010, accessed January 3, 2011, <http://www.state.gov/r/pa/ei/bgn/18902.htm>. China leapfrogged over Japan and became the world’s number two economy in the second quarter of 2010, as receding global growth sapped momentum and stunted a shaky recovery.

India’s economic liberalization in 1991 opened gates to businesses worldwide. In the mid- to late 1980s, Rajiv Gandhi’s government eased restrictions on capacity expansion, removed price controls, and reduced corporate taxes. While his government

viewed liberalizing the economy as a positive step, political pressures slowed the implementation of policies. The early reforms increased the rate of growth but also led to high fiscal deficits and a worsening current account. India's major trading partner then, the Soviet Union, collapsed. In addition, the first Gulf War in 1991 caused oil prices to increase, which in turn led to a major balance-of-payments crisis for India. To be able to cope with these problems, the newly elected Prime Minister Narasimha Rao along with Finance Minister Manmohan Singh initiated a widespread economic liberalization in 1991 that is widely credited with what has led to the Indian economic engine of today. Focusing on the barriers for private sector investment and growth, the reforms enabled faster approvals and began to dismantle the *License Raj*, a term dating back to India's colonial historical administrative legacy from the British and referring to a complex system of regulations governing Indian businesses. "Economic History of India," History of India, accessed January 7, 2011, [http://www.indohistory.com/economic\\_history\\_of\\_india.html](http://www.indohistory.com/economic_history_of_india.html).

Since 1990, India has been emerging as one of the wealthiest economies in the developing world. Its economic progress has been accompanied by increases in life expectancy, literacy rates, and food security. Goldman Sachs predicts that India's GDP in current prices will overtake France and Italy by 2020; Germany, the United Kingdom, and Russia by 2025; and Japan by 2035 to become the third-largest economy of the world after the United States and China. India was cruising at 9.4 percent growth rate until the financial crisis of 2008–9, which affected countries the world over. Mamta Badkar, "Race of the Century: Is India or China the Next Economic Superpower?," *Business Insider*, February 5, 2011, accessed May 18, 2011, <http://www.businessinsider.com/are-you-betting-on-china-or-india-2011-1?op=1>.

Both India and China have several strengths and weaknesses that contribute to the competitive battleground between them.

#### China's Strengths

1. **Strong government control.** China's leadership has a development-oriented ideology, the ability to promote capable individuals, and a system of collaborative policy review. The strong central government control has enabled the country to experience consistent and managed economic success. The government directs economic policy and its implementation and is less susceptible than democratic India to sudden changes resulting from political pressures.
2. **WTO and FDI.** China's entry into the World Trade Organization (WTO) and its foreign direct investment (FDI) in other global markets has been an important factor in the country's successful growth. Global businesses also find the consistency and predictability of the Chinese government a plus when evaluating direct investment.
3. **Cheap, abundant labor.** China's huge population offers large pools of skilled and unskilled workers, with fewer labor regulations than in India.
4. **Infrastructure.** The government has prioritized the development of the country's infrastructure including roads and highways, ports, airports, telecommunications networks, education, public health, law and order, mass transportation, and water and sewer treatment facilities.
5. **Effectiveness of two-pronged financial system.** "The first prong is a well-run directed-credit system that channels funds from bank and postal deposits to policy-determined public uses; the second is a profit-oriented and competitive system, albeit in early and inefficient stages of development. Both prongs continue to undergo rapid government-sponsored reforms to make them more effective." Albert Keidel, "E-Notes: Assessing China's Economic Rise: Strengths, Weaknesses and Implications," Foreign Policy Research Institute, July 2007, accessed January 3, 2011, [www.fpri.org/enotes/200707.keidel.assessingchina.html](http://www.fpri.org/enotes/200707.keidel.assessingchina.html).

#### India's Strengths



Infosys is one of India's new wave of world-class IT companies.

Image courtesy of Infosys.

1. **Quality manpower.** India has a technologically competent, English-speaking workforce. As a major exporter of technical workers, India has prioritized the development of its technology and outsourcing sectors. India is the global leader in the business process outsourcing (BPO) and call-center services industries.
2. **Open democracy.** India's democratic traditions are ingrained in its social and cultural fabric. While the political process can at times be tumultuous, it is less likely than China to experience big uncertainties or sudden revolutionary changes as those recently witnessed in the Middle East in late 2010 and early 2011.
3. **Entrepreneurship.** India entrepreneurial culture has led to global leaders, such as the Infosys cofounder, Narayana Murthy. Utilizing the global network of Indians in business and Indian business school graduates, India has an additional advantage over China in terms of entrepreneurship-oriented bodies, such as the TiE network (The Indus Entrepreneurs) or the Wadhvani Foundation, which seek to promote entrepreneurship by, among other things, facilitating investments. "Entrepreneurship: Riding Growth in India and China," INSEAD, accessed January 3, 2011, [knowledge.insead.edu/contents/Turner.cfm](http://knowledge.insead.edu/contents/Turner.cfm).
4. **Reverse brain drain.** Historically many emerging and developing markets experienced what is known as brain drain—where its best young people, once educated, moved to developed countries to access better jobs, incomes, and prospects for career advancement. In the past decade, economists have observed that the fast-growing economies of China and India are experiencing the reverse. Young graduates are remaining in India and China to pursue dynamic domestic opportunities. In fact, older professionals are returning from developed countries to seek their fortunes and career advancements in the promising local economies—hence the term *reverse brain drain*. The average age of the Indian returnees is thirty years old, and these adults are well educated—66 percent hold a master's degree, while 12 percent hold PhDs. The majority of these degrees are in management, technology, and science. Indians returning home are encouraged by the increasing transparency in business and government as well as the political freedoms and the prospects for economic growth. Vivek Wadhwa, "Beware the Reverse Brain Drain to India and China," *TechCrunch*, October 17, 2009, accessed January 7, 2011, <http://techcrunch.com/2009/10/17/beware-the-reverse-brain-drain-to-india-and-china>.
5. **Indian domestic-market growth.** According to the *Trade and Development Report 2010*, for sustainable growth, policies "should be based on establishing a balanced mix of domestic and overseas demand." Pioneer Edit Desk, "Expand Domestic Market," *The Pioneer*, September 20, 2010, accessed January 7, 2011, <http://dailypioneer.com/284197/Expand-domestic-market.html>. India has a good mix of both international and domestic markets.

Each country has embraced the trend toward urbanization differently. Global businesses are impacted in the way cities are run:

China is in much better shape than India is. While India has barely paid attention to its urban transformation, China has developed a set of internally consistent practices across every element of the urbanization operating model: funding, governance, planning, sectorial policies, and shape. India has underinvested in its cities; China has invested ahead of demand and given its cities the freedom to raise substantial investment resources by monetizing land assets and retaining a 25 percent share of value-added taxes. While India spends \$17 per capita in capital investments in urban infrastructure annually, China spends \$116. Indian cities have devolved little real power and accountability to its cities; but China's major cities enjoy the same status as provinces and have powerful and empowered political appointees as mayors. While India's urban planning system has failed to address competing demands for space, China has a mature urban planning regime that emphasizes the systematic development of run-down areas consistent with long-range plans for land use, housing, and transportation. Richard Dobbs and Shirish Sankhe, "Opinion: China vs. India," *Financial Times*, May 18, 2010, reprinted on McKinsey Global Institute website, accessed January 3, 2011, [www.mckinsey.com/mgi/mginews/opinion\\_china\\_vs\\_india.asp](http://www.mckinsey.com/mgi/mginews/opinion_china_vs_india.asp).

Despite the urbanization challenges, India is likely to benefit in the future from its younger demographics: "By 2025, nearly 28 percent of China's population will be aged 55 or older compared with only 16 percent in India." Richard Dobbs and Shirish Sankhe, "Opinion: China vs. India," *Financial Times*, May 18, 2010, reprinted on McKinsey Global Institute website, accessed January 3, 2011, [www.mckinsey.com/mgi/mginews/opinion\\_china\\_vs\\_india.asp](http://www.mckinsey.com/mgi/mginews/opinion_china_vs_india.asp). The trend toward urbanization is evident in both countries. By 2025, 64 percent of China's population will be living in urban areas, and 37 percent of India's people will be living in cities. Richard Dobbs and Shirish Sankhe, "Opinion: China vs. India," *Financial Times*, May 18, 2010, reprinted on McKinsey Global Institute website, accessed January 3, 2011, [www.mckinsey.com/mgi/mginews/opinion\\_china\\_vs\\_india.asp](http://www.mckinsey.com/mgi/mginews/opinion_china_vs_india.asp). This historically unique trend offers global businesses exciting markets.

So what markets are likely to benefit the most from these trends? In India, by 2025, the largest markets will be transportation and communication, food, and health care followed by housing and utilities, recreation, and education. Even India's slower-growing

spending categories will represent significant opportunities for businesses because these markets will still be growing rapidly in comparison with their counterparts in other parts of the world. In China's cities today, the fastest-growing categories are likely to be transportation and communication, housing and utilities, personal products, health care, and recreation and education. In addition, in both China and India, urban infrastructure markets will be massive. Richard Dobbs and Shirish Sankhe, "Opinion: China vs. India," *Financial Times*, May 18, 2010, reprinted on McKinsey Global Institute website, accessed January 3, 2011, [www.mckinsey.com/mgi/mginews/opinion\\_china\\_vs\\_india.asp](http://www.mckinsey.com/mgi/mginews/opinion_china_vs_india.asp).

While both India and China have unique strengths as well as many similarities, it's clear that both countries will continue to grow in the coming decades offering global businesses exciting new domestic markets. See also "India's Surprising Economic Miracle," *Economist*, September 30, 2010, accessed January 3, 2011, <http://www.economist.com/node/17147648>; "A Bumpier but Freer Road," *Economist*, September 3, 2010, accessed January 3, 2011, <http://www.economist.com/node/17145035>; Chris Monasterski, "Education: India vs. China," *Private Sector Development Blog*, World Bank, April 25, 2007, accessed January 7, 2011, [psdblog.worldbank.org/psdblog/2007/04/education\\_india.html](http://psdblog.worldbank.org/psdblog/2007/04/education_india.html); Shreyasi Singh, "India vs. China," *The Diplomat*, August 27, 2010, accessed January 7, 2011, <http://the-diplomat.com/indian-decade/2010/08/27/india-vs-china>; "The India vs. China Debate: One Up for India?," *Benzinga*, January 29, 2010, accessed January 7, 2011, <http://www.benzinga.com/global/104829/the-india-vs-china-debate-one-up-for-india>; Steve Hamm, "India's Advantages over China," *Bloomberg Business*, March 6, 2007, accessed January 7, 2011, [http://www.businessweek.com/globalbiz/blog/globespottting/archives/2007/03/indias\\_advantag.html](http://www.businessweek.com/globalbiz/blog/globespottting/archives/2007/03/indias_advantag.html).

### Opening Case Exercise

(AACSB: Ethical Reasoning, Multiculturalism, Reflective Thinking, Analytical Skills)

1. Pick an industry and company that interests you. As a global manager of the firm you've selected, you're asked to review China and India and determine which market to enter first. How would you evaluate each market and its potential customers? Use your understanding of the stage of development for each country from the case study as well as online resources. Which country would you recommend entering first? Based on your understanding of these markets, would you recommend a strategy for only one country or both?

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